

# AFFILIATED MANAGERS GROUP, INC.

1997 ANNUAL REPORT

M. HARRIS WITH LINDA  
SYSTEMATIC FINANCIAL  
PARADIGM ASSET MANA  
KEYLINE ASSET MANA  
RENAISSANCE ASSET  
FIRST QUADRANT GRO  
THE BURRIDGE GRO  
GOFEN AND GLOS  
GEOCAPITAL, LLC  
TWEEDY, BROWN  
ESSEX INVESTM

AMC is an asset management holding company which acquires majority interests in mid-sized investment management firms.

The Company's strategy is to generate growth through investments in new affiliates, as well as through the internal growth of existing affiliated firms.

Affiliated Managers Group, Inc.  
FINANCIAL HIGHLIGHTS

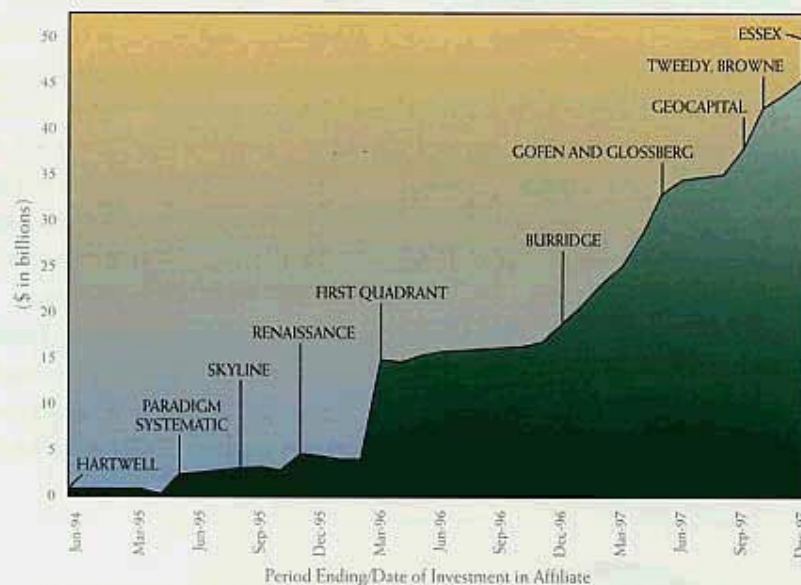
(dollars in thousands, except as indicated and per share data)	1996	1997	Pro Forma 1997 <sup>(3)</sup>
<b>Statement of Operations Data</b>			
Revenues	\$ 50,384	\$ 95,287	\$ 147,159
Operating income	7,171	22,561	47,112
Income (loss) before extraordinary item	(1,389)	1,643	8,761
Net income (loss)	(2,372)	(8,368)	8,761
Income (loss) before extraordinary item per share – basic	\$ (3.22)	\$ 0.72	\$ 0.50
Income (loss) before extraordinary item per share – diluted	(3.22)	0.20	0.49
Net income (loss) per share – basic	(5.49)	(3.69)	0.50
Net income (loss) per share – diluted	(5.49)	(1.02)	0.49
Average shares outstanding – basic	431,908	2,270,684	17,609,867
Average shares outstanding – diluted	431,908	8,235,529	17,767,913
<b>Other Financial Data</b>			
Assets under management at year end (in millions)	\$ 19,051	\$ 45,673	\$ 45,673
EBITDA <sup>(1)</sup>	10,524	20,044	45,010
EBITDA as adjusted <sup>(2)</sup>	7,596	10,201	26,695
<b>Balance Sheet Data</b>			
Total assets	\$ 101,335	\$ 456,990	\$ 456,990
Senior bank debt	33,400	159,500	159,500
Total stockholders' equity	36,989	259,740	259,740

<sup>(1)</sup> EBITDA represents earnings before interest, income taxes, depreciation, amortization and extraordinary item.

<sup>(2)</sup> EBITDA as adjusted represents earnings after interest expense and income taxes but before depreciation, amortization and extraordinary item.

<sup>(3)</sup> Pro forma financial data gives effect to investments and financing transactions which occurred during 1997 as if each of such transactions occurred as of January 1, 1997 and has been prepared in accordance with the Securities and Exchange Commission's Regulation S-X.

ASSETS UNDER MANAGEMENT <sup>(4)</sup>



<sup>(4)</sup> Pro forma as of December 31, 1997, including the investment in Essex, which closed on March 20, 1998



## P R E S I D E N T ' S   L E T T E R

### To Our Shareholders:

Affiliated Managers Group, Inc. (AMG) had an outstanding year in 1997. With three new investments, we grew to ten Affiliates with over \$45 billion in assets under management at year end. Our Affiliates achieved excellent internal growth, with assets under management increasing by 65% from year end 1996 (on a pro forma basis). Finally, our successful initial public offering in November positioned AMG for continued strong growth in the future.

Our 1997 financial results reflect both our success in adding new Affiliates and the continued growth of our existing Affiliates. On a reported basis, revenues increased 89% from \$50.4 million

in 1996 to \$95.3 million in 1997, while EBITDA (earnings before interest, income taxes, depreciation, amortization and extraordinary item) increased 91% to \$20.0 million compared with \$10.5 million in 1996. On a diluted basis, income per share before extraordinary item was \$0.20 in 1997 compared with a loss per share of \$3.22 in 1996. On a pro forma basis, EBITDA in 1997 was \$45.0 million, and 1997 income per share before extraordinary item was \$0.49 on a diluted basis.

We substantially strengthened the Company's capital base with AMG's initial public offering, which generated net proceeds of approximately \$187 million. By increasing our financial capacity and providing the added flexibility of a public stock to use

as an acquisition currency, the offering enhances our ability to continue to grow by investing in new Affiliates. We also expanded our capacity to fund investments in new Affiliates by increasing our revolving credit facility to \$300 million.

Assets under management by our Affiliates increased from \$27 billion at year end 1996 (on a pro forma basis) to over \$45 billion at year end 1997. This growth in assets under management was based on both strong investment performance and positive net client cash flows. Of the \$17.9 billion increase in assets under management among our Affiliates, \$11.9 billion represented positive net client cash flows.

Our Affiliates are well positioned across a range of investment styles, asset classes and client types. This diversification offers AMG a balanced business mix, while our Affiliates' significant participation in such fast growing segments as equities, global investments, and mutual funds gives us confidence in our Affiliates' prospects for continued strong internal growth in assets under management.

During 1997, we achieved substantial growth by making investments in three new Affiliates, each representing a distinct approach to investment management. In the second quarter, Gofen and Glossberg, a Chicago-based investment firm with nearly \$4 billion in assets under management, became an Affiliate. Gofen and Glossberg manages a



SENIOR MANAGEMENT: standing, Seth Brennan, Lee Chertavian, Jeff Murphy, Brian Girvan  
seated, Nate Dalton, Sean Healey

variety of portfolios for prominent individuals, families, retirement plans, foundations and endowments. In the third quarter, we added GeoCapital, which manages over \$2 billion in small-cap and special situation companies on behalf of corporations, retirement programs, foundations, high net worth individuals and private partnerships. In the fourth quarter, Tweedy, Browne Company, a well recognized leader in value investing, became an AMG Affiliate. Tweedy, Browne manages over \$5 billion in domestic and global equities on behalf of mutual funds, institutions, high net worth individuals and private partnerships. I am pleased to report that we have already begun 1998 on a similar pace, having completed in March an investment in Essex Investment Management Company, a Boston-based firm which manages over \$4 billion in assets. Essex specializes in investing in growth equities and fixed income securities employing a fundamental research-driven approach. With the completion of the investment in Essex, AMG has eleven Affiliates which collectively manage over \$50 billion in assets.

We achieved another important objective in 1997 by strengthening our management team and adding two new members to our Board of Directors. We enhanced our management depth with the addition of personnel to AMG's finance and acquisition areas. We also expanded our Board of Directors with the elections of John M. B.

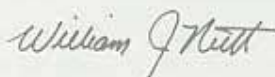
O'Connor, a partner of Chase Capital Partners, and William F. Weld, former Governor of Massachusetts and now a partner of McDermott, Will & Emery. We are confident that their experience and expertise will be beneficial in helping us achieve the next phase of our growth.

I would like to express my gratitude to Roger B. Kafker of TA Associates, a founding institutional investor in AMG, who will be leaving the board in 1998.

With the performance of our Affiliates, the increasing recognition of our innovative transaction structure as an attractive solution to the succession needs of growing mid-sized investment management firms, and with our

management team's proven track record in executing our strategy, we believe that we have assembled the key elements for continued growth. I would like to express our appreciation to our shareholders for their support and to thank our Affiliates, employees and management team for their outstanding contributions to a successful 1997. We look forward to continuing to capitalize on our opportunities in the future.

Sincerely,



William J. Nutt  
President, Chief Executive Officer and  
Chairman of the Board of Directors



Bill Nutt, President, Chief Executive Officer and  
Chairman of the Board of Directors



Widely recognized as one of the foremost practitioners of value investing, Tweedy, Browne Company has achieved remarkable growth in assets under management, with a compound annual growth rate of nearly 30% for the past five years. Tweedy, Browne, led by partners Christopher H. Browne, William H. Browne, and John D. Spears, contacted AMG in May 1997. They believed that AMG's approach would best solve their succession issues by providing liquidity for a portion of their interest, while both allowing them to capitalize on the firm's future growth through their retained ownership interest and insuring the continued autonomy of their firm's operations and investment process. AMG completed its investment in Tweedy, Browne Company LLC in October 1997.

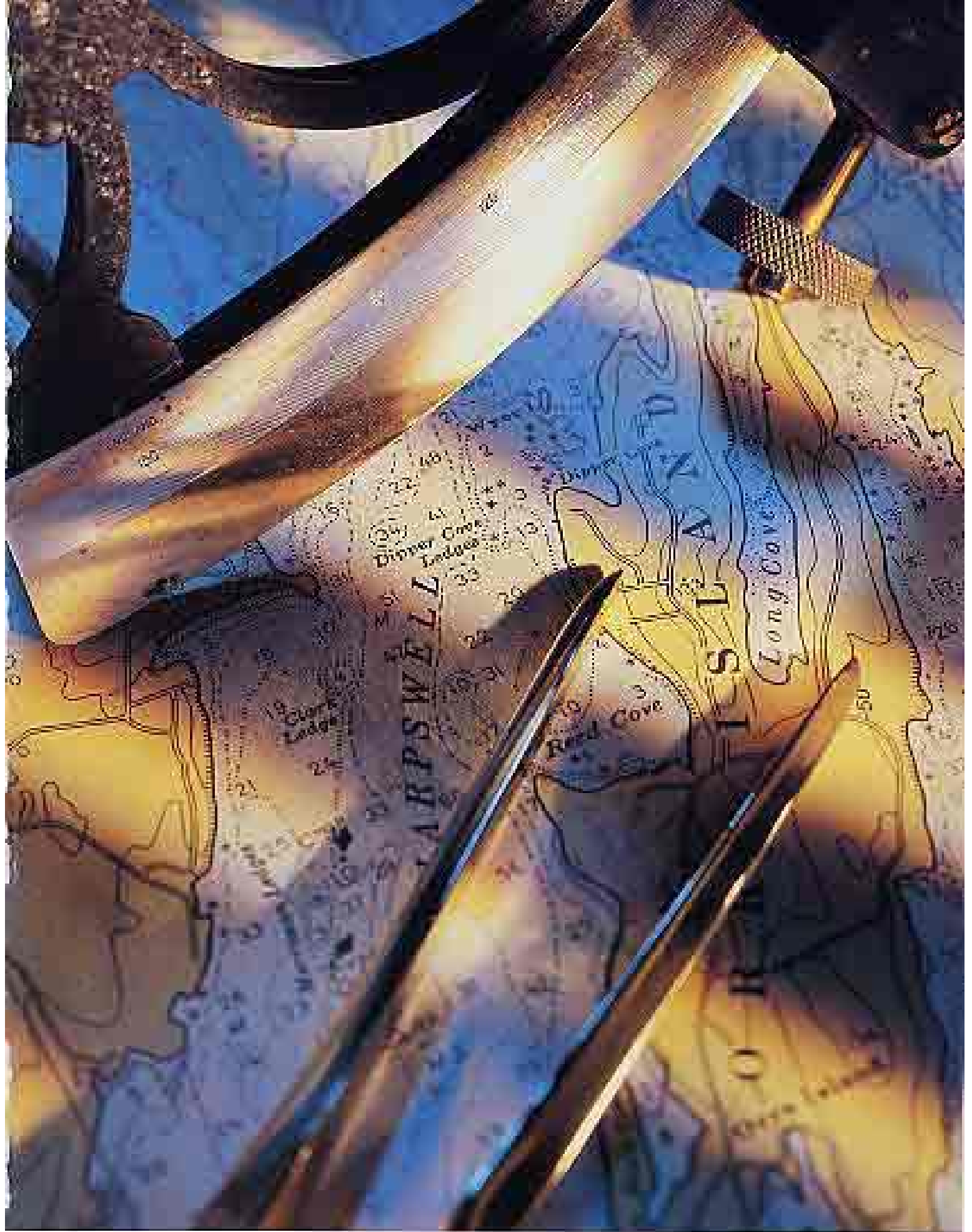
AMG's strategy is to become the preferred succession planning alternative for growing mid-sized investment management firms. As an asset management holding company, AMG seeks to generate growth through investments in new Affiliates, as well as through the internal growth of existing Affiliates.

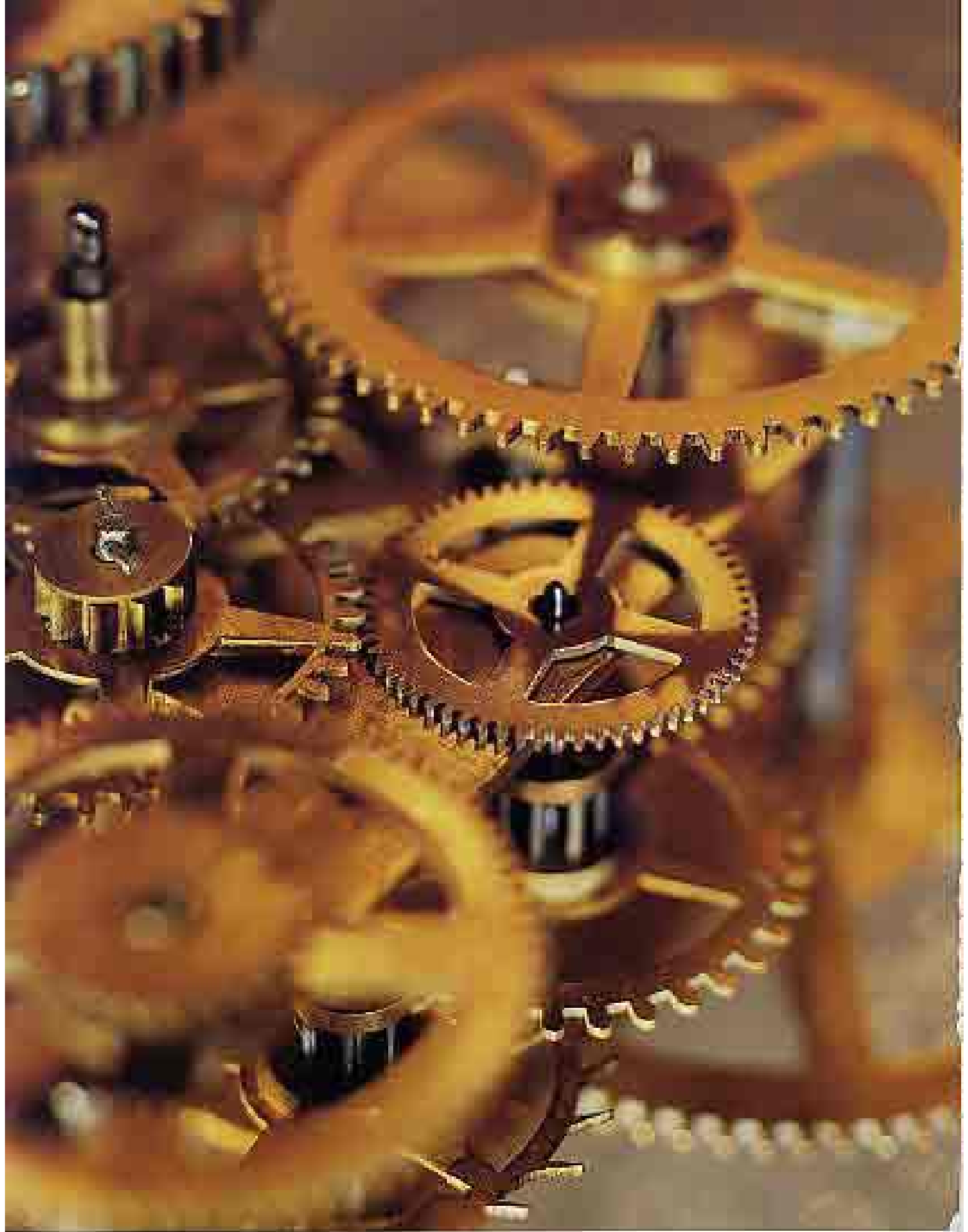
The foundation of AMG's approach is its innovative transaction structure (the "AMG Structure") which addresses the financial and operational needs of the managers, owners, and clients of growing mid-sized investment management firms. The AMG Structure allows owners of these firms to sell a portion of their interest, while ongoing management retains significant ownership, with the opportunity to realize value for that interest in the future. The AMG Structure also provides management of each Affiliate with autonomy over the day-to-day operations of their firm, and includes a revenue sharing arrangement which provides that a specified percentage of revenues are retained to pay operating expenses at the discretion of the Affiliate's management.



As the owners of successful mid-sized investment management firms plan for their succession and the continuity of their firms, they seek liquidity and a fair value for a portion of their equity to be sold today, with the opportunity for continued equity appreciation. Just as important is the certainty that they will be able to continue to manage their firm's operations and investment process without outside interference. The combination of retained equity and operational autonomy inherent in AMG's approach addresses all of these concerns in a way that a sale of 100% of a firm's equity cannot.

AMG believes that the opportunity for the managers of its Affiliates to realize value for their retained equity makes the AMG Structure particularly appealing to firms which anticipate strong future growth. The AMG Structure is designed to provide managers of those firms with an ongoing incentive to continue to grow their business.







A fundamental goal of AMG's approach is the alignment of interests among an Affiliate's clients, employees and owners (including both its management and AMG). AMG believes that investment management clients and their consultants understand that succession of a firm's management owners is inevitable, but they prefer it to occur in a structure which provides for both autonomy and an ongoing incentive for management to continue to provide superior investment performance and client service. By providing a firm's manage-



ment with a significant retained ownership interest, the AMG Structure ensures a substantial ongoing incentive for the management owners. In addition, by making the firm's equity available to succeeding members of management in the future, the AMG Structure also provides these same incentives for the firm's employees to provide superior performance and contribute to future growth.

AMG's approach appeals both to independently owned firms, which are seeking a solution which offers succession among individual managers and continuity for the firm, as well as to firms which are wholly or partially owned by outside entities. In each case, the AMG Structure allows for ongoing management to retain, or acquire, an ownership interest in their firm. The incentive provided by equity ownership and the stability allowed by operational autonomy serves to align the interests of the firm's clients, employees and owners.



The management team at First Quadrant built a world-class quantitative institutional investment management business. When their corporate parent decided to sell the firm, First Quadrant management was intent upon finding the option that was in the best interests of their clients and employees. Management decided that the AMG Structure provided the best incentives for them to grow their firm by continuing to offer innovative investment products and excellent client service.

The principals of Gofor and Glassberg, a firm with over sixty years of service to wealthy families, realized that they needed to plan for management succession within their business. The AMG Structure allowed the firm's senior management to begin reducing their interests while the next generation of management retained and, over time, can acquire additional ownership in their firm. Most importantly, AMG's approach accomplished their goals without disturbing the strong, personal relationships which their clients so highly value.

## AMG TARGET UNIVERSE



—◆—◆—◆—

*Growing Universe*

◆

*Additional Opportunities  
for Liftouts from Larger  
Organizations*

◆

*Broader Opportunities  
Internationally*

—◆—◆—◆—

Continuing AMG's momentum by making additional investments in growing asset management firms, whose management and owners recognize the benefits of AMG's approach, is expected to be a primary source of AMG's ongoing growth. AMG anticipates that it can continue implementing this growth strategy for two reasons: the large number of mid-sized asset management firms which represent substantial additional investment opportunities for AMG; and the attractiveness of AMG's investment approach to the owners of such firms. AMG has developed the resources and the ability to identify and capitalize on these growth opportunities with a disciplined calling program, the management expertise to execute new investments, and the financial flexibility to complete them.



There are numerous investment opportunities within AMG's target universe, with over 1,200 firms with assets under management of between \$500 million and \$10 billion in the United States, Canada, Europe and Asia. From this broad group, AMG has identified over 750 potential affiliates. AMG management has already introduced AMG's approach to a large number of these firms and continues to build new relationships through an active calling program. In the past several years, AMG has had discussions with over 400 firms, including over 300 on-site visits.

Once it elects to make an investment, AMG is equipped to complete the transaction quickly and in a manner which allows the prospective affiliate's management the least disruption from their primary responsibility, focusing on their clients. The experience and credibility gained from completing eleven investments to date, and the expertise of AMG's management in mergers and acquisitions coupled with AMG's financial capacity and flexibility, allow AMG to successfully and efficiently execute new investments. In addition, because AMG's approach ensures ongoing management autonomy and direct ownership in their firm, each firm's clients can be assured that the same incentives that were in place before an investment by AMG will continue in the future.



J.M. HARRIS WITH TAYLOR  
SYSTEMATIC INVESTMENT  
PARADIGM ASSET MANAGEMENT  
SKYLINE ASSET MANAGEMENT  
RENAISSANCE INVESTMENT  
FIRST QUADRANT LP  
THE BURRIDGE GROUP LLC  
GOFEN AND GLOSSBERG  
GEOCAPITAL, LLC  
TWEEDY, BROWNE COMPANY  
ESSEX INVESTMENT







Owners of Affiliates choose AMG rather than selling 100% of their firm, in the belief that the future value of their retained equity in their firm will be greater than its value today. The AMG Structure is most appealing to managers of firms who anticipate strong future growth and want to have direct equity participation in that growth.



The opportunities for capital appreciation on their retained equity, along with annual participation to their firm's profits, provides powerful ongoing incentives for the management of each Affiliate. These combined annual and long-term financial rewards provide strong motivation for them to build the value of their firm: by generating positive net client cash flows; by delivering exceptional investment performance; by providing superior client service; and by improving operational effectiveness.



AMG supports the efforts of its Affiliates by offering access to broader resources for growth initiatives as well as for operational enhancements. Recent support initiatives have included assistance with new product development, marketing material development, recruiting, compliance audits, client satisfaction surveys, and discounted pricing on a range of third party services. Recognizing the importance of each Affiliate's autonomy and unique culture, this assistance is provided only on an "as requested" basis.

In addition, twice a year, AMG organizes the Affiliate Forum which includes senior management from each Affiliate and provides an opportunity to hear speakers discuss industry trends, to participate in seminars on areas of shared interest, and to interact with peers from other firms who share a common affiliation.



Upon becoming an AMG Affiliate, Skyline managed two mutual funds, which were primarily distributed through a regional brokerage firm as well as a major fund supermarket. With assistance from AMG, Skyline commissioned a review of additional distribution channels which resulted in AMG assisting Skyline in the development of a mutual fund strategy to focus on registered investment advisors. Building on the success of that initial effort, AMG recently aided Skyline's management in developing a new investment product by offering advice, providing marketing support, and assisting in the sourcing of seed capital.

## DIVERSIFICATION

Among its Affiliates, AMG enjoys a broad diversity of asset classes, investment styles, client types, distribution channels, and geography of investments. AMG seeks to continue to invest in firms which participate in rapidly growing segments of the asset management industry, as well as to capture the benefits of exposure to multiple avenues of distribution. This breadth of exposure enables AMG to participate in the higher growth areas of the industry, while providing a level of stability against volatility or changing prospects which an individual industry segment may experience. Consequently, AMG continues to seek investments in firms which participate in the same or similar areas as the current Affiliates, but also will seek further diversification by investing in firms with exposure to other sectors.

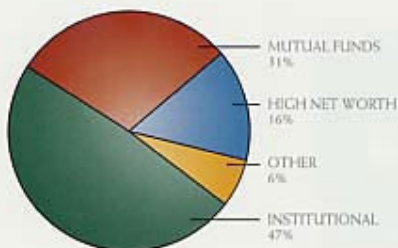


AMG measures its participation in various segments of the asset management industry by contribution to AMG's EBITDA, rather than by amount of assets under management (which does not necessarily reflect their relative importance to AMG's results). By this measure, AMG's Affiliates have substantial participation in fast-growing sectors of the investment management business, such as equities, mutual funds, and global investments.

### DIVERSITY BY EBITDA CONTRIBUTION

Pro Forma For the Year Ended December 31, 1997

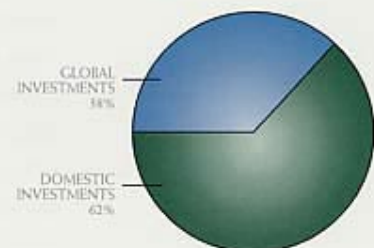
CLIENT TYPE



ASSET CLASS



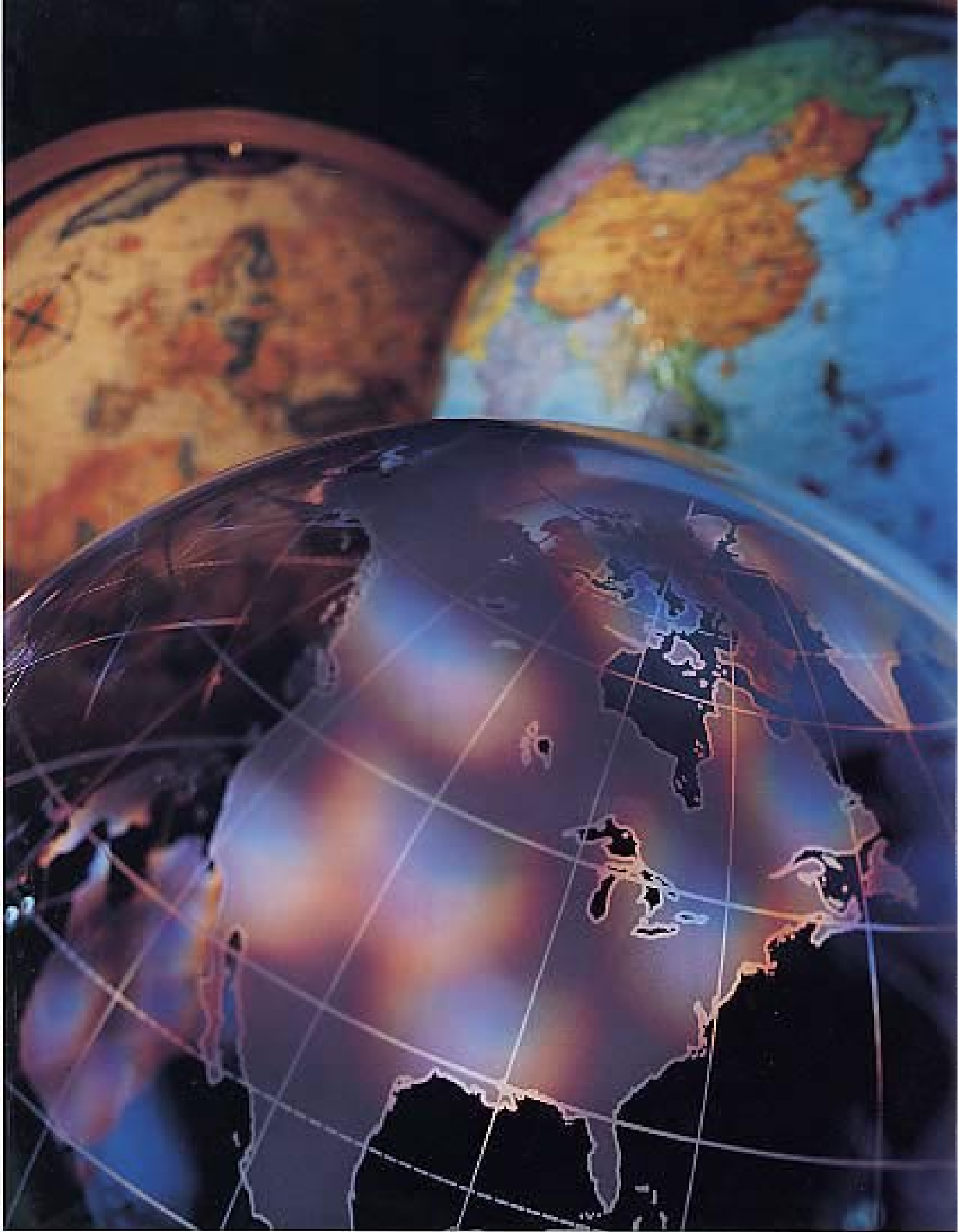
GEOGRAPHY



EBITDA Contribution represents the portion of an Affiliate's revenues that is allocated to the Company, after amounts retained by the Affiliate for compensation and day-to-day operating and overhead expenses, but before the interest, income tax, depreciation and amortization expenses of the Affiliate. EBITDA Contribution does not include holding company expenses. The Company believes that EBITDA Contribution may be useful to investors as an indicator of each Affiliate's contribution to the Company's ability to service debt,

to make new investments and to meet working capital requirements. EBITDA Contribution is not a measure of financial performance under generally accepted accounting principles and should not be considered an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. EBITDA Contribution and EBITDA, as calculated by the Company, may not be consistent with comparable computations by other companies.





◆ **The Burrige Group LLC**

The Burrige Group is a Chicago-based firm that specializes in the management of mid-cap growth equity portfolios. Burrige's clients include corporate, Taft-Hartley and public pension plans, as well as foundations, endowments and individuals.

◆ **Essex Investment Management Company, LLC \***

Essex is a Boston-based investment management firm which specializes in investing in growth equities and fixed income securities on behalf of institutional and private clients. Essex offers a range of products which employ the same fundamental research, active portfolio management, and focus on identifying company earnings growth, profitability, and franchise opportunities that Essex believes will achieve superior investment returns.

◆ **First Quadrant, L.P.**

One of the largest quantitative investment managers in the world, Pasadena-based First Quadrant, L.P., together with its London-based sister company First Quadrant Ltd., pioneered the use of asset allocation and style management on a global basis. With an emphasis on research and publishing, First Quadrant applies advanced information technology and artificial intelligence techniques to leverage traditional methods of building quantitative investment systems. First Quadrant provides its services to large domestic and international corporate and public entities and pension plans.

◆ **GeoCapital, LLC**

Based in New York, GeoCapital invests in domestic small-cap equities on behalf of corporate and retirement programs, foundations, high net worth individuals and private partnerships. The firm's investment approach is to manage fully invested portfolios that blend two types of stocks: growth companies and special situations.

◆ **Gofen and Glossberg, L.L.C.**

Based in Chicago, Gofen and Glossberg is one of the oldest and most respected investment counseling firms in the United States. The firm has a long history of managing assets for prominent individuals, families, retirement plans, foundations and endowments. Gofen and Glossberg takes a long-term approach to portfolio management – typically three to five years – in order to preserve capital and encourage growth.

◆ **J.M. Hartwell Limited Partnership**

J.M. Hartwell is a New York-based growth stock manager whose clients include high net worth individuals, an offshore hedge fund and several large private foundations. The firm uses a disciplined selection process to identify stocks of companies with strong fundamentals and exposure to long-term trends.

◆ **Paradigm Asset Management Company, L.L.C.**

Paradigm Asset Management employs an investment approach that combines passive management technology with active management insights. Paradigm's investment process identifies several portfolio management styles from a set of active managers and then, using a modeling process, arrives at a smaller portfolio of stocks. Based in New York, Paradigm offers six styles that employ this investment process: large-cap growth, large-cap value, mid-cap growth, mid-cap value, small-cap growth and small-cap value.

◆ **Renaissance Investment Management**

Based in Cincinnati, Renaissance utilizes disciplined quantitative techniques in conjunction with traditional fundamental analysis in identifying investment opportunities within and among asset classes. Renaissance offers large cap, small cap and international equity management, focusing investments in growth companies that are trading at reasonable valuations. Renaissance also offers tactical asset allocation, balanced and fixed income management.

◆ **Skyline Asset Management, L.P.**

Skyline is a Chicago-based investment advisor that specializes in small-cap value equities. The firm manages assets for numerous institutional clients and also for three no-load mutual funds: *Skyline Special Equities Portfolio*, *Skyline Special Equities II* and the *Skyline Small Cap Contrarian Fund*. Each of the firm's strategies leads to the selection of stocks with low valuations and attractive earnings growth prospects.

◆ **Systematic Financial Management, L.P.**

Located in Teaneck, New Jersey, Systematic Financial Management manages portfolios for corporations, pension funds and high net worth individuals employing value-based strategies. The firm provides several products including large and small-cap value equity and free cash flow value equity.

◆ **Tweedy, Browne Company, LLC**

Tweedy, Browne is a leading practitioner of the value-oriented investment approach advocated by Benjamin Graham. The firm seeks to invest in companies at a substantial discount to their true business value while emphasizing a long-term, low turnover strategy grounded in individual stock selection. Tweedy, Browne provides investment management for institutions, individuals, partnerships, offshore funds and two mutual funds, *Tweedy, Browne American Value* and *Tweedy, Browne Global Value*.

\*AMG completed its investment in Essex on March 20, 1998.



## FORWARD-LOOKING STATEMENTS

When used in this Annual Report and in future filings by Affiliated Managers Group, Inc. (the "Company" or "AMG") with the Securities and Exchange Commission, in the Company's press releases and in oral statements made with the approval of an authorized executive officer, the words or phrases "will likely result", "are expected to", "will continue", "is anticipated", "believes", "estimate", "project" or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties, including those discussed under the caption "Business-Cautionary Statements", which are set forth in the Company's 1997 Form 10-K that could cause actual results to differ materially from historical earnings and results and from any opinions or statements expressed with respect to future periods in any current statements. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made.

The Company will not undertake and specifically declines any obligation to release publicly the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

## OVERVIEW

The Company acquires equity positions in mid-sized investment management firms, and derives its revenues from such firms ("Affiliate" or "Affiliates"). AMG has a revenue sharing arrangement with each Affiliate which is contained in the organizational document of that Affiliate. Each such arrangement allocates a specified percentage of revenues (typically 50-70%) for use by management of that Affiliate in paying operating expenses of the Affiliate, including salaries and bonuses (the "Operating Allocation"). The remaining portion of revenues of the Affiliate, typically 30-50% (the "Owners' Allocation"), is allocated to the owners of that Affiliate (including the Company), generally in proportion to their ownership of the Affiliate.

One of the purposes of the revenue sharing arrangements is to provide ongoing incentives for the managers of the Affiliates. The revenue sharing arrangements are designed to allow each Affiliate's managers to participate in that firm's growth (through their compensation paid out of the Operating Allocation and their ownership of a portion of the Owners' Allocation) and to make operating expenditures freely

within the limits of the Operating Allocation. The portion of the Operating Allocation that is not used to pay salaries and other operating expenses (the "Excess Operating Allocation") is generally available to be used at the discretion of management of such Affiliate, including for the payment of bonuses or distributions to management. The managers of each Affiliate thus have an incentive to increase revenues (thereby increasing the Operating Allocation) and control expenses (thereby increasing the Excess Operating Allocation). The ownership by an Affiliate's management of a portion of the Affiliate, which entitles them to a portion of the Owners' Allocation, provides an important additional incentive to managers of each Affiliate to increase revenues.

The revenue sharing arrangements allow AMG to participate in the growth of revenues of each Affiliate, because as revenues increase, the Owners' Allocation also increases. However, the Company participates in that growth to a lesser extent than the managers of the Affiliate, because AMG does not participate in the growth of the Operating Allocation.

The portion of each Affiliate's revenues which is included in its Operating Allocation and used to pay salaries, bonuses and other operating expenses, as well as the portion of each Affiliate's revenues which is included in its Owners' Allocation and distributed to AMG and the other owners of the Affiliate, are both included as "revenues" on the Company's Consolidated Statements of Operations. The expenses of each Affiliate which are paid out of the Operating Allocation, as well as the holding company expenses of AMG which are paid by the Company out of the Owners' Allocation which AMG receives from the Affiliates, are both included in "operating expenses" on the Company's Consolidated Statements of Operations. The portion of each Affiliate's Owners' Allocation which is allocated to owners of the Affiliates other than the Company is included in "minority interest" on the Company's Consolidated Statements of Operations.

The EBITDA Contribution of an Affiliate represents the Owners' Allocation of that Affiliate allocated to AMG before interest, income taxes, depreciation and amortization of that Affiliate. EBITDA Contribution does not include holding company expenses of AMG.

The Affiliates' revenues are derived from the provision of investment management services for fees. Investment management fees are usually determined as a percentage fee charged on periodic values of a client's assets under management. Certain of the Affiliates bill advisory fees for all or a portion of their clients based upon assets under management valued at the beginning of a billing period ("in advance"). Other



Affiliates bill advisory fees for all or a portion of their clients based upon assets under management valued at the end of the billing period ("in arrears"). Advisory fees billed in advance will not reflect subsequent changes in the market value of assets under management for that period. Conversely, advisory fees billed in arrears will reflect changes in the market value of assets under management for that period. In addition, several of the Affiliates charge performance-based fees to certain of their clients which result in payments to the applicable Affiliate if specified levels of investment performance are achieved. All references to "assets under management" include assets directly managed as well as assets underlying overlay strategies which employ futures, options or other derivative securities to achieve a particular investment objective.

The Company's level of profitability will depend on a variety of factors including principally: (i) the level of Affiliate revenues, which is dependent on the ability of the Affiliates and future affiliates to maintain or increase assets under management by maintaining their existing investment advisory relationships and fee structures, marketing their services successfully to new clients, and obtaining favorable investment results; (ii) the receipt of Owners' Allocation, which is dependent on the ability of the Affiliates and future affiliates to maintain certain levels of operating profit margins; (iii) the availability and cost of the capital with which AMG finances its investments; (iv) the Company's success in attracting new investments and the terms upon which such transactions are completed; (v) the level of intangible assets and the associated amortization resulting from the Company's investments; (vi) the level of expenses incurred by AMG for holding company operations, including compensation for its employees; and (vii) the level of taxation to which the Company is subject, all of which are, to some extent, dependent on factors which are not in the Company's control, such as general securities market conditions.

Since its founding in December 1993, the Company has completed 11 investments in Affiliates. The most recent investment, Essex, was completed in March 1998 and is not included in pro forma operating results except where indicated. In May, September and October 1997, the Company completed investments in Gofen and Glossberg, GeoCapital and Tweedy, Browne, respectively. The Company also made investments during March and December 1996, in First Quadrant and Burrige, respectively. The Tweedy, Browne investment is the Company's largest to date, representing 54% of the Affiliates' pro forma EBITDA Contribution (which does not include Essex) for the year ended December 31, 1997.

The Company's investments have been accounted for un-

der the purchase method of accounting under which goodwill is recorded for the excess of the purchase price for the acquisition of interests in Affiliates over the fair value of the net assets acquired, including acquired client relationships.

As a result of the series of investments made by the Company, intangible assets (goodwill and acquired client relationships) constitute a substantial percentage of the assets of the Company and the Company's results of operations have included increased charges for amortization of those intangible assets. As of December 31, 1997, the Company's total assets were approximately \$457.0 million, of which approximately \$142.9 million consisted of "acquired client relationships" and \$249.7 million consisted of "goodwill" (collectively, acquired client relationships and goodwill are referred to as "intangible assets"). The amortization period for intangible assets for each investment is assessed individually, with amortization periods for the Company's investments to date ranging from nine to 26 years in the case of acquired client relationships and 15 to 35 years in the case of goodwill. In determining the amortization period for intangible assets acquired, the Company considers a number of factors including: the firm's historical and potential future operating performance; the firm's historical and potential future rates of attrition among clients; the stability and longevity of existing client relationships; the firm's recent, as well as long-term, investment performance; the characteristics of the firm's products and investment styles; the stability and depth of the firm's management team; and the firm's history and perceived franchise or brand value. The Company continuously evaluates all components of intangible assets to determine whether there has been any impairment in their carrying value or their useful lives. The Company makes such evaluations quarterly on an Affiliate-by-Affiliate basis to assess if facts and circumstances exist which suggest an impairment has occurred in the value of the intangible assets or if the amortization period needs to be shortened. If such a condition exists, the Company will evaluate the recoverability of the intangible asset by preparing a projection of the undiscounted future cash flows of the Affiliate. If impairment is indicated, then the carrying amount of intangible assets, including goodwill, will be reduced to their fair values.

While amortization of intangible assets has been charged to the results of operations and is expected to be a continuing material component of the Company's operating expenses, management believes it is important to distinguish this expense from other operating expenses since such amortization does not require the use of cash. Because of this, and because the Company's distributions from its Affiliates are based on their Owners' Allocation, management has provided



# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

additional supplemental information in this annual report for "cash-related" earnings, as an addition to, but not as a substitute for, measures related to net income. Such measures are (i) EBITDA (earnings before interest, income taxes, depreciation, amortization and extraordinary item), which the Company believes is useful to investors as an indicator of the Company's ability to service debt, make new investments and meet working capital requirements, and (ii) EBITDA as adjusted (earnings after interest and income taxes, but before depreciation, amortization and extraordinary item), which the Company believes is useful to investors as another indicator of funds available to the Company, which may be used to make new investments, repay debt obligations, repurchase shares of the Company's common stock ("Common Stock") or pay dividends on Common Stock.

## RESULTS OF OPERATIONS

### Supplemental Pro Forma Information

Affiliate operations are included in the Company's historical financial statements from their respective dates of acquisition. The Company consolidates Affiliates when it owns a controlling interest and includes in minority interest the portion of capital and Owners' Allocation owned by persons other than the Company. One of the Company's Affiliates, Paradigm, is not controlled by the Company and is accounted for under the equity method of accounting.

Because the Company has made investments during each of the periods for which financial statements are presented, the Company believes that the historical operating results for these periods are not directly comparable. Substantially all of the changes in the Company's income, expense and balance sheet categories result from the inclusion of the acquired businesses from the dates of their investment.

All amounts in the table which follows are pro forma for the inclusion of the 1997 investments in Gofen and Glossberg, GeoCapital and Tweedy, Browne as if such transactions occurred on January 1, 1997. In addition, EBITDA Contribution and other pro forma financial data reflect the Company's Recent Financing (with interest expense adjusted for the terms of the New Credit Facility) (as such terms are defined in "Liquidity and Capital Resources"), the sale of Common Stock sold in the Company's initial public offering ("IPO") and the application of the net proceeds therefrom, the conversion of preferred stock into Common Stock, the 50-for-1 split of each share of Common Stock outstanding prior to the IPO, and the issuance of shares of Common Stock to the shareholders of an Affiliate in exchange for an additional ownership interest in that Affiliate,

all effected in connection with the initial public offering. Such information is provided to enhance the reader's understanding and evaluation of the effects to the Company of Tweedy, Browne, AMC's largest Affiliate by EBITDA Contribution.

### Unaudited Pro Forma Supplemental Information

(in millions)	at December 31, 1997
Assets under Management – at period end:	
Tweedy, Browne	\$ 5,343
Other Affiliates	40,330
<b>Total</b>	<b>\$ 45,673</b>

(in thousands)	Year Ended December 31, 1997
Revenues:	
Tweedy, Browne	\$ 53,506
Other Affiliates	93,653
<b>Total</b>	<b>\$ 147,159</b>
Owners' Allocation <sup>(1)</sup> :	
Tweedy, Browne	\$ 36,314
Other Affiliates <sup>(2)</sup>	36,838
<b>Total</b>	<b>\$ 73,152</b>
EBITDA Contribution <sup>(1)</sup> :	
Tweedy, Browne	\$ 28,643
Other Affiliates <sup>(3)</sup>	24,778
<b>Total</b>	<b>\$ 53,421</b>
Other Pro Forma Financial Data:	
Reconciliation of EBITDA	
Contribution to EBITDA	
Total EBITDA Contribution (as above)	\$ 53,421
Less holding company expenses	(8,411)
<b>EBITDA <sup>(1)</sup></b>	<b>\$ 45,010</b>
<b>EBITDA as adjusted <sup>(1)</sup></b>	<b>\$ 26,695</b>
Historical Cash Flow and Other Data:	
Cash flow from operating activities	\$ 16,205
Cash flow used in investing activities	(327,275)
Cash flow from financing activities	327,112
<b>EBITDA <sup>(1)</sup></b>	<b>\$ 20,044</b>
<b>EBITDA as adjusted <sup>(1)</sup></b>	<b>\$ 10,201</b>

(1) As defined in "Management's Discussion and Analysis of Financial Condition and Results of Operation – Overview"

(2) No Affiliate other than Tweedy, Browne accounted for more than 16% of Owners' Allocation for the year ended December 31, 1997. No single client relationship accounted for more than 3% of Owner's Allocation for the year ended December 31, 1997.

(3) No Affiliate other than Tweedy, Browne accounted for more than 17% of EBITDA Contribution for the year ended December 31, 1997.



# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The table below depicts the pro forma change in the Company's assets under management (assuming that all Affiliates in which the Company owned an interest at December 31, 1997 were included for the entire year).

## Pro Forma Change in Assets Under Management

(in millions)	Year Ended December 31, 1997
Assets under management – beginning	\$ 27,747
Net new sales	11,942
Market appreciation	5,984
Assets under management – ending	\$ 45,673

## HISTORICAL

### Year Ended December 31, 1997 as Compared to Year Ended December 31, 1996

The Company had a net loss after extraordinary item of \$8.4 million for the year ended December 31, 1997 compared to a net loss after extraordinary item of \$2.4 million for the year ended December 31, 1996. The net loss for the year ended December 31, 1997 resulted primarily from the extraordinary item of \$10.0 million, net of related tax benefit, from the early extinguishment of debt. Before extraordinary item, net income was \$1.6 million for the year ended December 31, 1997 compared to a net loss of \$1.4 million for the year ended December 31, 1996.

Assets under management on a historical basis increased by \$26.6 billion to \$45.7 billion at December 31, 1997 from \$19.1 billion at December 31, 1996, in part due to the investments made in Gofen and Glossberg, GeoCapital and Tweedy, Browne during 1997. Excluding the initial assets under management of these Affiliates at the respective dates of the Company's investments, assets under management increased by \$15.8 billion as a result of \$4.6 billion in market appreciation and \$11.2 billion from positive net client cash flows.

Total revenues for the year ended December 31, 1997 were \$95.3 million, an increase of \$44.9 million or 89% over the year ended December 31, 1996. The Company invested in Burr ridge in December 1996, Gofen and Glossberg in May 1997, GeoCapital in September 1997 and Tweedy, Browne in October 1997, and included their results from their respective purchase dates. In addition, the Company invested in First Quadrant in March 1996 and its results were included in the results for the year ended December 31, 1996 from its purchase date. Revenues from these investments accounted for

\$43.1 million of the increase in revenues from 1996 to 1997 while revenues from other existing Affiliates increased by \$1.8 million to \$26.7 million. Performance-based fees, primarily earned by First Quadrant, increased by \$4.0 million to \$17.2 million for the year ended December 31, 1997 compared to \$13.2 million for the year ended December 31, 1996.

Compensation and related expenses increased by \$20.5 million to \$41.6 million for the year ended December 31, 1997 from \$21.1 million for the year ended December 31, 1996. The inclusion of the First Quadrant, Burr ridge, Gofen and Glossberg, GeoCapital and Tweedy, Browne investments accounted for \$19.3 million of this increase while the remainder of the increase was attributable to the increased compensation costs of AMG personnel, including the cost of new hires.

Amortization of intangible assets decreased by \$1.5 million to \$6.6 million for the year ended December 31, 1997 from \$8.1 million for the year ended December 31, 1996. Amortization of intangible assets increased by \$3.1 million as a result of the inclusion of the First Quadrant, Burr ridge, and Gofen and Glossberg, GeoCapital and Tweedy, Browne investments, which increase was offset by an impairment loss of \$4.6 million taken on the Systematic investment during 1996 with no similar item in 1997.

Selling, general and administrative expenses increased by \$8.0 million to \$18.9 million for the year ended December 31, 1997 from \$10.9 million for the year ended December 31, 1996. The First Quadrant, Burr ridge, Gofen and Glossberg, GeoCapital and Tweedy, Browne investments accounted for \$6.0 million of this increase and the remainder was primarily due to increases in AMG's and the other Affiliates' selling, general and administrative expenses.

Other operating expenses increased by approximately \$1.3 million to \$3.6 million for the year ended December 31, 1997 from \$2.3 million for the year ended December 31, 1996, primarily due to the results of operations of the new Affiliates described above.

Minority interest increased by \$6.2 million to \$12.2 million for the year ended December 31, 1997 from \$6.0 million for the year ended December 31, 1996. Of this increase, \$5.4 million was as a result of the addition of new Affiliates as described above and the remainder was due to the Owners' Allocation growth at the Company's existing Affiliates.

Interest expense increased \$5.8 million to \$8.5 million for the year ended December 31, 1997 from \$2.7 million for the year ended December 31, 1996 as a result of the increased



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

indebtedness incurred in connection with the investments described above. See "Liquidity and Capital Resources".

Income tax expense was \$1.4 million for the year ended December 31, 1997 compared to \$181,000 for the year ended December 31, 1996. The effective tax rate for the year ended December 31, 1997 was 46% compared to 15% for the year ended December 31, 1996. The change in effective tax rates from 1996 to 1997 is related primarily to the change in the provision for federal taxes from 1996 to 1997. In 1996, the Company recorded a federal deferred tax benefit of \$233,000 on a pretax loss of \$1.2 million. In 1997, the Company recorded a deferred tax expense of \$776,000 on pretax income of \$3.0 million. The deferred taxes account for the effects of temporary differences between the recognition of deductions for book and tax purposes primarily related to the accelerated amortization of certain intangible assets.

EBITDA increased by \$9.5 million to \$20.0 million for the year ended December 31, 1997 from \$10.5 million for the year ended December 31, 1996 as a result of the inclusion of new Affiliates as described above and revenue growth.

EBITDA as adjusted increased by \$2.6 million to \$10.2 million for the year ended December 31, 1997 from \$7.6 million for the year ended December 31, 1996 as a result of the factors affecting net income as described above, before non-cash expenses such as amortization of intangible assets, depreciation and extraordinary items of \$18.6 million for the year ended December 31, 1997 and \$10.0 million for the year ended December 31, 1996.

### Year Ended December 31, 1996 as Compared to Year Ended December 31, 1995

Net loss was \$2.4 million for the year ended December 31, 1996 compared to \$2.9 million for the year ended December 31, 1995. The change was a result of the higher operating income from Affiliates in 1996 which was offset by an extraordinary item of \$983,000 and higher depreciation and amortization, interest and minority interest expenses resulting from the inclusion of certain Affiliate results for a full year in 1996 compared to partial periods in 1995 and from the inclusion of First Quadrant's results from its acquisition date in March 1996.

Assets under management on a historical basis increased by \$14.5 billion to \$19.1 billion at December 31, 1996 from \$4.6 billion at December 31, 1995, primarily as a result of the investments made in First Quadrant and Burrige which were completed in March 1996 and December 1996, respectively.

Excluding the initial assets under management of these Affiliates at their date of investment, assets under management increased by \$2.0 billion as a result of net positive client cash flows of \$495.0 million and \$1.5 billion in market appreciation.

Consolidated revenues increased \$36.2 million to \$50.4 million for the year ended December 31, 1996 from \$14.2 million for the year ended December 31, 1995. Of this increase, \$25.5 million was attributable to the investment in First Quadrant in March 1996. In addition, for the year ended December 31, 1996, the results of Systematic, Paradigm, Skyline and Renaissance were included for the full period. Each of those Affiliates was only included for a portion of the year ended December 31, 1995. Performance-based fees increased by \$11.8 million to \$13.2 million for the year ended December 31, 1996 primarily due to the inclusion of First Quadrant which earned performance fees of \$11.5 million for the period ended December 31, 1996. The Company completed its investment in Burrige on December 31, 1996.

Compensation and related expenses increased \$15.1 million to \$21.1 million for the year ended December 31, 1996 from \$6.0 million for the year ended December 31, 1995. Of this increase, \$8.1 million was attributable to the inclusion of First Quadrant. As noted above, for the year ended December 31, 1996, the expenses of each of Systematic, Skyline and Renaissance were included for the full period. In addition, \$1.1 million was attributable to the increased compensation costs of AMG personnel, including the cost of new hires.

The amortization of intangible assets increased by \$3.9 million to \$8.1 million for the year ended December 31, 1996 from \$4.2 million for the year ended December 31, 1995. Of this increase, approximately \$700,000 was attributable to the First Quadrant investment and \$1.2 million was due to the inclusion of the other recently acquired Affiliates for the full period. In the year ended December 31, 1996, the Company also recognized an impairment loss of \$4.6 million in connection with its investment in Systematic which is included in amortization of intangible assets. The loss reflects the write down of Systematic's intangible assets to its net realizable value following a period of net client asset withdrawals. In the year ended December 31, 1995, AMG also recognized \$2.5 million of impairment loss in connection with its Hartwell investment following a loss of client assets.

Selling, general and administrative expenses increased from \$2.2 million for the year ended December 31, 1995



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

to \$10.9 million for the year ended December 31, 1996 for the reasons stated above related to the periods of inclusion in the results of operations of the new Affiliates and due to \$1.8 million of higher selling, general and administrative expenses incurred by AMG relating to its investment activities.

Other operating expenses increased from \$330,000 for the year ended December 31, 1995 to \$2.3 million for the year ended December 31, 1996. This \$2.0 million increase was primarily due to the inclusion of operations for the First Quadrant investment for nine months and the Renaissance investment for a full year in 1996.

Minority interest increased by \$3.5 million to \$6.0 million for the year ended December 31, 1996 from \$2.5 million for the year ended December 31, 1995, as a result of the addition of new Affiliates during the year and revenue growth at the Company's Affiliates.

Interest expense increased from \$1.2 million for the year ended December 31, 1995 to \$2.7 million for the year ended December 31, 1996. The increase in the interest expense was due to the incurrence of \$16.1 million of average bank borrowings by the Company in connection with the Systematic, Paradigm, Skyline and Renaissance transactions and \$16.0 million of average bank borrowings incurred in connection with the 1996 investment in First Quadrant for the nine months ended December 31, 1996.

Income tax expense was \$181,000 for the year ended December 31, 1996 compared to \$706,000 for the year ended December 31, 1995. The Company did not accrue a current provision for federal income taxes in 1996 as a result of its utilization of net operating loss carryforwards. The net operating loss carryforwards resulted from prior periods of net losses from operations. The Company has established a valuation allowance against the resulting net deferred tax asset. The effective tax rate for the year ended December 31, 1996 was 15% compared to 32% for the year ended December 31, 1995. The 1995 provision for taxes included \$445,000 for state and local income taxes and \$261,000 of federal income taxes. The federal income tax provision included \$201,000 of deferred taxes for the effects of timing differences between the recognition of deductions for book and tax purposes primarily related to the accelerated amortization of certain intangible assets.

EBITDA increased \$7.2 million to \$10.5 million for the year ended December 31, 1996 from \$3.3 million for the

year ended December 31, 1995 as a result of the inclusion of new Affiliates as described above and revenue growth.

EBITDA as adjusted increased by \$6.2 million to \$7.6 million for the year ended December 31, 1996 from \$1.4 million for the year ended December 31, 1995, as a result of factors affecting net income as described above before non-cash charges such as amortization of intangible assets, depreciation and extraordinary items of \$10.0 million for the year ended December 31, 1996 and \$4.3 million for the year ended December 31, 1995.

### LIQUIDITY AND CAPITAL RESOURCES

The Company has met its cash requirements primarily through cash generated by its operating activities, bank borrowings, the issuance by the Company of equity and debt securities in private placement transactions and the net proceeds from the sale of 8,625,000 shares of Common Stock in an initial public offering in November 1997. The Company anticipates that it will use cash flow from its operating activities to repay debt and to finance its working capital needs and will use bank borrowings and issue equity and debt securities to finance future investments in affiliates and working capital. The Company's principal uses of cash have been to make investments in Affiliates, to retire indebtedness, and to support the Company's and its Affiliates' operating activities. The Company expects that its principal use of funds for the foreseeable future will be for investments in additional affiliates, repayments of debt, including interest payments on outstanding debt, distributions of the Owners' Allocation to owners of Affiliates other than AMG, additional investments in existing Affiliates including upon the exercise of Puts (as defined elsewhere herein) and for working capital purposes. The Company does not expect to make commitments for material capital expenditures.

Net cash flow from operating activities was \$16.2 million, \$6.2 million and \$1.3 million for the years ended December 31, 1997, 1996 and 1995, respectively.

Net cash flow used in investing activities was \$327.3 million, \$29.2 million and \$37.8 million for the years ended December 31, 1997, 1996 and 1995, respectively. Of these amounts, \$325.9 million, \$25.6 million, and \$38.0 million, respectively, were used to make investments in Affiliates.

Net cash flow from financing activities was \$327.1 million,



\$15.7 million and \$46.4 million for the years ended December 31, 1997, 1996 and 1995, respectively. The principal sources of cash from financing activities has been from borrowings under senior credit facilities and subordinated debt, private placements of the Company's equity securities and the Company's IPO. The uses of cash from financing activities during these periods were for the repayment of bank debt, repayment of subordinated debt, repayment of notes issued as purchase price consideration and for the payment of debt issuance costs.

At December 31, 1997, the Company had cash and cash equivalents of \$22.8 million and outstanding borrowings of senior debt under its New Credit Facility, as defined below, of \$159.5 million.

During 1997, the Company made investments in three new Affiliates, Gofen and Glossberg, GeoCapital and Tweedy, Browne, and made additional investments in two of its existing Affiliates which required approximately \$325.9 million in cash (including transaction costs). The Company obtained the financing for these investments pursuant to (i) borrowings under the Credit Facility, (ii) borrowings of \$60 million face amount of Subordinated Bridge Notes (the "Subordinated Debt") and (iii) \$30 million from the issuance of Class C Convertible Preferred Stock and warrants to purchase Class C Convertible Preferred Stock (clauses (i) – (iii) collectively, the "Recent Financing"). The Credit Facility included \$200 million in revolving credit and \$50 million of 7-year Tranche A and \$50 million of 8-year Tranche B term loans.

On November 21, 1997, the Company successfully completed its IPO with the sale of 8,625,000 shares of Common Stock. The Company received net proceeds of \$187.0 million, after deducting the underwriting discount and expenses payable by the Company in connection with the offering. The Company used the proceeds of the offering to retire the Subordinated Debt of \$60 million, the Tranche A term loan of \$50 million, the Tranche B term loan of \$50 million, \$25.8 million of the revolving credit facility and accrued interest of \$1.2 million.

The Company replaced its Credit Facility with a new credit facility ("New Credit Facility") during December 1997. The New Credit Facility allows for borrowings up to \$300 million (which may be increased to \$400 million upon the approval of the lenders), bears interest at either LIBOR plus a margin ranging from 0.50% to 2.25% or the Prime Rate plus a margin ranging up to 1.25% and matures during

December 2002. The Company pays a commitment fee of up to 1/2 of 1% on the daily unused portion of the facility.

The Company's borrowings under the New Credit Facility are collateralized by pledges of all of its interests in Affiliates (including all interests in Affiliates which are directly held by the Company, as well as all interests in Affiliates which are indirectly held by the Company through wholly-owned subsidiaries), representing substantially all of the Company's assets at December 31, 1997. The credit agreement (the "Credit Agreement") evidencing the New Credit Facility contains a number of negative covenants, including those which prevent the Company and its Affiliates from: (i) incurring additional indebtedness (with certain enumerated exceptions, including additional borrowings under the New Credit Facility and borrowings which constitute Subordinated Indebtedness (as that term is defined in the Credit Agreement)), (ii) creating any liens or encumbrances on any of their assets (with certain enumerated exceptions), (iii) selling assets outside the ordinary course of business or making certain fundamental changes with respect to the Company or any of its subsidiaries, including a restriction on the Company's ability to transfer interests in its subsidiaries if, as a result of such transfer, the Company would own less than 51% of such subsidiary, and (iv) declaring or paying dividends on the Common Stock of the Company.

The Credit Agreement also requires the Company to comply with certain financial covenants on an ongoing basis. These include a covenant requiring minimum stockholders' equity of \$36.0 million (plus 85% of net proceeds from offerings of equity and Subordinated Indebtedness (as such term is defined in the Credit Agreement) and 50% of quarterly net income (or minus certain quarterly net losses) after the date of the Credit Agreement), a covenant requiring that Consolidated EBITDA (as such term is defined in the Credit Agreement) exceed interest expense by 2.0 to 1.0; and a covenant requiring that senior debt not exceed adjusted EBITDA (as such term is defined in the Credit Agreement) by more than 5.0 to 1.0. The Company remains in compliance with each of the foregoing financial covenants. The Company's ability to borrow under the Credit Agreement is conditioned upon its compliance with the requirements of that agreement, and any non-compliance with those requirements could give rise to a default entitling the lenders to accelerate all outstanding borrowings under that agreement.



In August 1997, the Company issued to Chase Equity Associates 5,333 (pre-split) shares of Series C-2 Non-Voting Convertible Preferred Stock and warrants to purchase at nominal cost 28,000 (pre-split) shares of Series C-2 Non-Voting Convertible Preferred Stock for aggregate cash consideration of \$30.0 million. As partial consideration in the GeoCapital investment, the Company issued 10,667 (pre-split) shares of Class D Convertible Preferred Stock valued at \$9.6 million.

On March 20, 1998, the Company acquired a majority interest in Essex Investment Management, LLC. The Company paid \$69.6 million in cash and the assumption of debt, in addition to 1,750,942 newly-issued shares of Class C Convertible Non-Voting Stock. The stock will automatically convert into AMG Common Stock at a 1-for-1 exchange ratio after one year. The Company funded the cash portion of this investment with borrowings under its New Credit Facility.

In order to provide the funds necessary for the Company to continue to acquire interests in investment management firms, including its Affiliates upon the exercise of Puts, it will be necessary for the Company to incur, from time to time, additional long-term bank debt and/or issue equity or debt securities, depending on market and other conditions. There can be no assurance that such additional financing will be available or become available on terms acceptable to the Company.

#### INTEREST RATE SENSITIVITY

The Company's revenues are derived almost exclusively from fees which are based on the value of assets under management. Such values are affected by changes in the broader financial markets which are, in part, affected by changing interest rates. The Company cannot predict the effects that interest rates or changes in interest rates may have on either the broader financial markets or its Affiliates' assets under management and associated fees.

With respect to its debt financings, the Company is exposed to potential fluctuations in the amount of interest expense resulting from changing interest rates. The Company seeks to offset such exposure in part by entering into interest rate hedging contracts. See "Interest Rate Hedging Contracts" below.

The Company's annual interest expense increases or decreases by \$199,375 for each 1/8 of 1% change in interest

rates assuming LIBOR is between 5% and 6.78% and assuming current interest rate margins on bank debt.

#### INTEREST RATE HEDGING CONTRACTS

The Company seeks to offset its exposure under its debt financing arrangements to changing interest rates by entering into interest rate hedging contracts. The Company generally borrows at a floating rate equal to LIBOR plus a margin as described above. As of December 31, 1997, the Company is a party, with two major commercial banks as counterparties, to \$185 million notional amount of swap contracts which are designed to limit interest rate increases on the Company's borrowings. The swap contracts, upon quarterly reset dates, cap interest rates on the notional amounts when LIBOR exceeds 6.67% or 6.78%. When LIBOR is at or below 5%, the Company's floating LIBOR-based interest rate debt is swapped for fixed rate debt at rates ranging between 6.67% and 6.78%. The hedging contracts limit the effects of the Company's payment of interest at equivalent LIBOR rates of 6.78% or less on up to \$185 million of indebtedness. However, there can be no assurance that the Company will continue to maintain such hedging contracts at their existing levels of coverage or that the amount of coverage maintained will cover all of the Company's indebtedness outstanding at any such time. In addition, as noted above, the Company's existing hedging contracts subject the Company to the risk of payments of higher interest rates when prevailing LIBOR rates are at 5% or less. Therefore, there can be no assurance that the hedging contracts will meet their overall objective of reducing the Company's interest expense. In addition, there can be no assurance that the Company will be successful in obtaining hedging contracts in the future on any new indebtedness.

#### IMPACT OF THE YEAR 2000 ISSUE

The Year 2000 Issue is the result of computer programs being written using two digits rather than four to define the applicable year. Any of the Company's or its Affiliates' computer programs that have date-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in a system failure or miscalculations causing disruptions of operations, including, among other things, a temporary inability to process transactions, send



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

invoices, or engage in similar normal business activities.

Based on a recent assessment, the Company determined that the Year 2000 Issue will not have a significant impact on its own systems. The Company has communicated with its Affiliates and plans to initiate a formal communication with all of its significant vendors to determine the extent to which the Company is vulnerable to those third parties who fail to remediate their own Year 2000 Issue.

At this time, the Company's assessment of the impact of the Year 2000 Issue is incomplete. The Company's assessment is expected to be completed during 1998, when all of its Affiliates and significant vendors have completed their individual assessments of the issue.

### RECENT ACCOUNTING DEVELOPMENTS

In June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income." This standard requires that comprehensive income and its components be reported and displayed in a financial statement with the same prominence as other financial statements. Comprehensive income includes net income, as well as certain items that are recorded directly in stockholders' equity, such as foreign currency translation adjustments. This standard is effective for years beginning after December 15, 1997, and will not have a material impact on the Company's financial position or results of operations.

In June 1997, the FASB issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." This standard requires disclosure of financial and descriptive information about an entity's reportable operating segments. Segments are defined by the standard as components of an entity that engage in business activities that generate revenues and expenses, and for which separate financial information should be reported on the basis that is used internally for senior management review. This standard is effective for financial statements for periods beginning after December 15, 1997, with restatement of comparative information for prior periods. The Company is currently evaluating the impact of this standard on its disclosures.

### ECONOMIC AND MARKET CONDITIONS

The financial markets and the investment management industry in general have experienced record performance and

record growth in recent years. For example, between January 1, 1995 and December 31, 1997, the S&P 500 Index appreciated at a compound annual rate in excess of 31.2% while, according to the Federal Reserve Board and the Investment Company Institute, aggregate assets under management of mutual and pension funds grew at a compound annual rate approaching 20% for the period January 1, 1995 to December 31, 1996. The financial markets and businesses operating in the securities industry, however, are highly volatile and are directly affected by, among other factors, domestic and foreign economic conditions and general trends in business and finance, all of which are beyond the control of the Company. There can be no assurance that broader market performance will be favorable in the future. Any decline in the financial markets or a lack of sustained growth may result in a corresponding decline in performance by the Affiliates and may adversely affect assets under management and/or fees at the Affiliate level, which would reduce cash flow distributions to the Company.

### INTERNATIONAL OPERATIONS

First Quadrant Limited is organized and headquartered in London, England. Tweedy, Browne, based in New York, also maintains a research office in London. In the future, the Company may seek to invest in other investment management firms which are located and/or conduct a significant part of their operations outside of the United States. There are certain risks inherent in doing business internationally, such as changes in applicable laws and regulatory requirements, difficulties in staffing and managing foreign operations, longer payment cycles, difficulties in collecting investment advisory fees receivable, political instability, fluctuations in currency exchange rates, expatriation controls and potential adverse tax consequences. There can be no assurance that one or more of such factors will not have a material adverse effect on First Quadrant Limited or other non-U.S. investment management firms in which the Company may invest in the future and, consequently, on the Company's business, financial condition and results of operations.

### INFLATION

The Company does not believe that inflation or changing prices have had a material impact on its results of operations.



SELECTED HISTORICAL FINANCIAL DATA

Set forth below are selected financial data for the Company for the four years since inception, December 29, 1993. This data should be read in conjunction with, and is qualified in its entirety by reference to, the financial statements and accompanying notes included elsewhere in this Annual Report.

(in thousands, except as indicated and per share data)	For the Years Ended December 31,			
	1994	1995	1996	1997
<b>Statement of Operations Data</b>				
Revenues	\$ 5,374	\$ 14,182	\$ 50,384	\$ 95,287
Operating expenses:				
Compensation and related expenses	3,591	6,018	21,113	41,619
Amortization of intangible assets	774	4,174	8,053	6,643
Depreciation and other amortization	19	133	932	1,915
Other operating expenses	1,000	2,567	13,115	22,549
Total operating expenses	5,384	12,892	43,213	72,726
Operating income (loss)	(10)	1,290	7,171	22,561
Non-operating (income) and expenses:				
Investment and other income	(966)	(265)	(337)	(1,174)
Interest expense	158	1,244	2,747	8,479
	(808)	979	2,410	7,305
Income before minority interest, income taxes and extraordinary item	798	311	4,761	15,256
Minority interest <sup>(1)</sup>	(305)	(2,541)	(5,969)	(12,249)
Income (loss) before income taxes and extraordinary item	493	(2,230)	(1,208)	3,007
Income taxes	699	706	181	1,364
Income (loss) before extraordinary item	(206)	(2,936)	(1,389)	1,643
Extraordinary item	—	—	(983)	(10,011)
Net (loss)	\$ (206)	\$ (2,936)	\$ (2,372)	\$ (8,368)
Net (loss) per share <sup>(2)</sup> – basic	\$ (0.07)	\$ (2.95)	\$ (5.49)	\$ (3.69)
Net (loss) per share <sup>(2)</sup> – diluted	\$ (0.07)	\$ (2.95)	\$ (5.49)	\$ (1.02)
Average shares outstanding – basic	3,030,548	996,144	431,908	2,270,684
Average shares outstanding – diluted	3,030,548	996,144	431,908	8,235,529
<b>Other Financial Data</b>				
Assets under management (at period end, in millions)	\$ 755	\$ 4,615	\$ 19,051	\$ 45,673
EBITDA <sup>(3)</sup>	1,444	3,321	10,524	20,044
EBITDA as adjusted <sup>(3)</sup>	587	1,371	7,596	10,201
Cash flow from operating activities	818	1,292	6,185	16,205
Cash flow used in investing activities	(6,156)	(37,781)	(29,210)	(327,275)
Cash flow from financing activities	9,509	46,414	15,650	327,112
<b>Balance Sheet Data</b>				
Current assets	\$ 4,791	\$ 16,847	\$ 23,064	\$ 52,058
Acquired client relationships, net	3,482	18,192	30,663	142,875
Goodwill, net	5,417	26,293	40,809	249,698
Total assets	13,808	64,699	101,335	456,990
Current liabilities	2,021	4,111	23,591	18,815
Senior debt	—	18,400	33,400	159,500
Total liabilities	3,925	26,620	60,856	180,771
Minority interest <sup>(1)</sup>	80	1,212	3,490	16,479
Preferred stock	10,004	40,008	42,476	—
Stockholders' equity	9,803	36,867	36,989	259,740

(1) All but one of the Company's Affiliates are majority-owned subsidiaries (the Company owns less than a 50% interest in Paradigm which is accounted for under the equity method of accounting). The portion of each Affiliate's operating results and net assets that are owned by minority owners of each Affiliate is accounted for as minority interest.

(2) The Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 128, "Earnings per Share" ("FAS 128"). This standard became effective for financial statements issued for periods ending after December 15, 1997. The Company has adopted FAS 128 for its fiscal year ending December 31, 1997 and has restated prior-period EPS data to conform to the new standard. The

calculation for the basic earnings per share is based on the weighted average of common shares outstanding during the period. The calculation for the diluted earnings per share is based on the weighted average of common and common equivalent shares outstanding during the period. Because the computation of diluted EPS shall not assume exercise of securities that would have an anti-dilutive effect on earnings per share, as in the case in a loss year before extraordinary item, the effect of outstanding convertible preferred stock and unvested restricted common stock was excluded from the diluted calculation in 1994, 1995 and 1996.

(3) As defined by in "Management's Discussion and Analysis of Financial Condition and Results of Operation – Overview".



REPORT OF INDEPENDENT ACCOUNTANTS

TO THE BOARD OF DIRECTORS  
AND STOCKHOLDERS OF  
AFFILIATED MANAGERS GROUP, INC.

We have audited the accompanying consolidated balance sheets of Affiliated Managers Group, Inc. and Affiliates as of December 31, 1997 and 1996, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Affiliated Managers Group, Inc. and Affiliates as of December 31, 1997 and 1996 and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1997 in conformity with generally accepted accounting principles.

*Cooper & Lybman, L.L.P.*

Boston, Massachusetts

February 10, 1998 except for Note 16 for which the date is March 20, 1998.



Affiliated Managers Group, Inc.  
CONSOLIDATED BALANCE SHEETS

(in thousands)	December 31,	
	1996	1997
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 6,767	\$ 22,766
Investment advisory fees receivable	15,491	27,061
Other current assets	806	2,231
Total current assets	23,064	52,058
Fixed assets, net	2,999	4,724
Equity investment in Affiliate	1,032	1,237
Acquired client relationships, net of accumulated amortization of \$2,979 in 1996 and \$6,142 in 1997	30,663	142,875
Goodwill, net of accumulated amortization of \$10,022 in 1996 and \$13,502 in 1997	40,809	249,698
Other assets	2,768	6,398
Total assets	\$ 101,335	\$ 456,990
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 16,212	\$ 18,815
Notes payable to related parties	7,379	—
Total current liabilities	23,591	18,815
Senior bank debt	33,400	159,500
Accrued affiliate liability	3,200	—
Other long-term liabilities	665	1,656
Subordinated debt	—	800
Total liabilities	60,856	180,771
Minority interest	3,490	16,479
Commitments and contingencies		
Stockholders' equity:		
Preferred stock	42,476	—
Common stock	—	177
Additional paid-in capital on common stock	5	273,475
Foreign translation adjustment	22	(30)
Accumulated deficit	(5,514)	(13,882)
Total stockholders' equity	36,989	259,740
Total liabilities and stockholders' equity	\$ 101,335	\$ 456,990

The accompanying notes are an integral part of the consolidated financial statements.



CONSOLIDATED STATEMENTS OF OPERATIONS

(dollars in thousands, except per share data)

	For the Years Ended December 31,		
	1995	1996	1997
Revenues	\$ 14,182	\$ 50,384	\$ 95,287
Operating expenses:			
Compensation and related expenses	6,018	21,113	41,619
Amortization of intangible assets	4,174	8,053	6,643
Depreciation and other amortization	133	932	1,915
Selling, general and administrative	2,237	10,854	18,912
Other operating expenses	330	2,261	3,637
	12,892	43,213	72,726
Operating income	1,290	7,171	22,561
Non-operating (income) and expenses:			
Investment and other income	(265)	(337)	(1,174)
Interest expense	1,244	2,747	8,479
	979	2,410	7,305
Income before minority interest, income taxes and extraordinary item	311	4,761	15,256
Minority interest	(2,541)	(5,969)	(12,249)
Income (loss) before income taxes and extraordinary item	(2,230)	(1,208)	3,007
Income taxes	706	181	1,364
Income (loss) before extraordinary item	(2,936)	(1,389)	1,643
Extraordinary item, net	—	(983)	(10,011)
Net (loss)	\$ (2,936)	\$ (2,372)	\$ (8,368)
Income (loss) per share – basic:			
Income (loss) before extraordinary item	\$ (2.95)	\$ (3.22)	\$ 0.72
Extraordinary item, net	—	(2.27)	(4.41)
Net (loss)	\$ (2.95)	\$ (5.49)	\$ (3.69)
Income (loss) per share – diluted:			
Income (loss) before extraordinary item	\$ (2.95)	\$ (3.22)	\$ 0.20
Extraordinary item, net	—	(2.27)	(1.22)
Net (loss)	\$ (2.95)	\$ (5.49)	\$ (1.02)
Average shares outstanding – basic	996,144	431,908	2,270,684
Average shares outstanding – diluted	996,144	431,908	8,235,529

The accompanying notes are an integral part of the consolidated financial statements.



CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

For the Years Ended December 31,

1995 1996 1997

Cash flow from operating activities:			
Net (loss)	\$ (2,936)	\$ (2,372)	\$ (8,368)
Adjustments to reconcile net (loss) to net cash flow from operating activities:			
Amortization of intangible assets	4,174	8,053	6,643
Extraordinary item	—	983	10,011
Minority interest	631	2,309	13,108
Depreciation and other amortization	133	932	1,915
Increase (decrease) in deferred income taxes	141	(215)	—
Changes in assets and liabilities:			
Increase in investment advisory fees receivable	(186)	(8,473)	(3,980)
Increase in other current assets	(397)	(1,881)	(977)
Increase (decrease) in accounts payable, accrued expenses and other liabilities	(268)	6,849	(2,147)
Cash flow from operating activities	1,292	6,185	16,205
Cash flow used in investing activities:			
Purchase of fixed assets	(287)	(922)	(1,648)
Costs of investments, net of cash acquired	(38,031)	(25,646)	(325,896)
Sale of investment	—	642	—
Distributions received from Affiliate equity investment	—	275	229
Increase (decrease) in other assets	216	(3,639)	40
Repayment on notes recorded in purchase of business	321	80	—
Cash flow used in investing activities	(37,781)	(29,210)	(327,275)
Cash flow from financing activities:			
Borrowings of senior bank debt	28,400	21,000	303,900
Repayments of senior bank debt	(10,000)	(6,000)	(177,800)
Repayments of notes payable	(962)	(1,212)	(5,878)
Borrowings of subordinated debt	—	—	58,800
Repayments of subordinated debt	—	—	(60,000)
Issuances of equity securities	20,001	2,485	217,021
Issuance of warrants	—	—	1,200
Payment of subscription receivable	10,000	—	—
Repurchase of preferred stock	—	(13)	—
Debt issuance costs	(1,024)	(610)	(10,131)
Cash flow from financing activities	46,414	15,650	327,112
Effect of foreign exchange rate changes on cash flow	—	46	(43)
Net increase (decrease) in cash and cash equivalents	9,925	(7,329)	15,999
Cash and cash equivalents at beginning of year	4,171	14,096	6,767
Cash and cash equivalents at end of year	\$ 14,096	\$ 6,767	\$ 22,766
Supplemental disclosure of cash flow information:			
Interest paid	\$ 1,005	\$ 2,905	\$ 8,559
Income taxes paid	696	436	256
Supplemental disclosure of non-cash investing activities:			
Increase (decrease) in liabilities related to acquisitions	3,200	—	(3,200)
Supplemental disclosure of non-cash financing activities:			
Preferred stock issued in acquisitions	—	—	11,101
Common stock issued in exchange for Affiliate equity interests	—	—	1,849
Notes issued in acquisitions	—	6,686	—
Conversion of preferred stock to common stock	—	—	83,576
Exchange of common stock for preferred stock	10,004	—	—

The accompanying notes are an integral part of the consolidated financial statements.



Affiliated Managers Group, Inc.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(dollars in thousands)	Preferred Shares	Common Shares	Preferred Stock	Common Stock	Additional Paid-In Capital	Foreign Translation Adjustments	Accumulated Deficit	Total Stockholders' Equity
December 31, 1994	40,000	2,550,000	\$ 10,004	\$ —	\$ 5	\$ —	\$ (206)	\$ 9,803
Issuance of common stock	—	275,000	—	—	—	—	—	—
Payment of subscription receivable	—	—	—	—	10,000	—	—	10,000
Exchange of common stock for preferred stock	40,000	(2,000,000)	10,004	—	(10,004)	—	—	—
Issuance of preferred stock	29,851	—	20,000	—	—	—	—	20,000
Net loss	—	—	—	—	—	—	(2,936)	(2,936)
December 31, 1995	109,851	825,000	40,008	—	1	—	(3,142)	36,867
Issuance of common stock	—	162,500	—	—	4	—	—	4
Issuance of preferred stock	3,703	—	2,481	—	—	—	—	2,481
Repurchase of preferred stock	(20)	—	(13)	—	—	—	—	(13)
Net loss	—	—	—	—	—	—	(2,372)	(2,372)
Foreign translation adjustment	—	—	—	—	—	22	—	22
December 31, 1996	113,534	987,500	42,476	—	5	22	(5,514)	36,989
Issuance of common stock	—	8,753,667	—	98	188,773	—	—	188,871
Issuance of preferred stock and warrants	45,715	—	41,100	—	1,200	—	—	42,300
Conversion of preferred stock	(159,249)	7,962,450	(83,576)	79	83,497	—	—	—
Net loss	—	—	—	—	—	—	(8,368)	(8,368)
Foreign translation adjustment	—	—	—	—	—	(52)	—	(52)
December 31, 1997	—	17,703,617	\$ —	\$ 177	\$ 273,475	\$ (30)	\$ (13,882)	\$ 259,740

The accompanying notes are an integral part of the consolidated financial statements



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

# 1. BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

## Organization and Nature of Operations

The principal business activity of Affiliated Managers Group, Inc. ("AMG" or the "Company") is the acquisition of equity interests in investment management firms ("Affiliates"). AMG's Affiliates operate in one industry segment, that of providing investment management services, primarily in the United States and Europe, to mutual funds, partnerships and institutional and individual clients.

Affiliates are either organized as limited partnerships, general partnerships or limited liability companies. AMG has contractual arrangements with each Affiliate whereby a percentage of revenues is allocable to fund Affiliate operating expenses, including compensation (the "Operating Allocation"), while the remaining portion of revenues (the "Owners' Allocation") is allocable to AMG and the other partners or members, generally with a priority to AMG. Affiliate operations are consolidated in these financial statements. The portion of the Owners' Allocation allocated to owners other than AMG is included in minority interest in the statement of operations. Minority interest on the consolidated balance sheets includes undistributed Owners' Allocation and Operating Allocation and capital owned by owners other than AMG.

## Consolidation

These consolidated financial statements include the accounts of AMG and each Affiliate in which AMG has a controlling interest. In each such instance, AMG is, directly or indirectly, the sole general partner (in the case of Affiliates which are limited partnerships), sole managing general partner (in the case of the Affiliate which is a general partnership) or sole manager member (in the case of Affiliates which are limited liability companies). Investments where AMG does not hold a controlling interest are accounted for under the equity method of accounting and AMG's portion of net income is included in investment and other income. All intercompany balances and transactions have been eliminated.

## Revenue Recognition

The Company's consolidated revenues represent advisory fees billed quarterly and annually by Affiliates for managing the assets of clients. Asset-based advisory fees are recognized monthly as services are rendered and are based upon a per-

centage of the market value of client assets managed. Any fees collected in advance are deferred and recognized as income over the period earned. Performance-based advisory fees are recognized when earned based upon either the positive difference between the investment returns on a client's portfolio compared to a benchmark index or indices, or an absolute percentage of gain in the client's account, and are accrued in amounts expected to be realized.

## Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. Cash equivalents are stated at cost, which approximates market value due to the short-term maturity of these investments.

## Fixed Assets

Equipment and other fixed assets are recorded at cost and depreciated using the straight-line method over their estimated useful lives ranging from three to five years. Leasehold improvements are amortized over the shorter of their estimated useful lives or the term of the lease.

## Acquired Client Relationships and Goodwill

The purchase price for the acquisition of interests in Affiliates is allocated based on the fair value of assets acquired, primarily acquired client relationships. In determining the allocation of purchase price to acquired client relationships, the Company analyzes the net present value of each acquired Affiliate's existing client relationships based on a number of factors including: the Affiliate's historical and potential future operating performance; the Affiliate's historical and potential future rates of attrition among existing clients; the stability and longevity of existing client relationships; the Affiliate's recent, as well as long-term, investment performance; the characteristics of the firm's products and investment styles; the stability and depth of the Affiliate's management team; and the Affiliate's history and perceived franchise or brand value. The cost assigned to acquired client relationships is amortized using the straight line method over periods ranging from nine to 26 years. The expected useful lives of acquired client relationships are analyzed separately for each acquired Affiliate and determined based on an analysis of the historical and potential future attrition rates of each Affiliate's existing clients, as well as a consideration of the specific attributes of the business of each Affiliate.



The excess of purchase price for the acquisition of interests in Affiliates over the fair value of net assets acquired, including acquired client relationships, is classified as goodwill. Goodwill is amortized using the straight-line method over periods ranging from 15 to 35 years. In determining the amortization period for goodwill, the Company considers a number of factors including: the firm's historical and potential future operating performance; the characteristics of the firm's clients, products and investment styles; as well as the firm's history and perceived franchise or brand value. Unamortized intangible assets, including acquired client relationships and goodwill, are periodically re-evaluated and if experience subsequent to the acquisition indicates that there has been an impairment in value, other than temporary fluctuations, an impairment loss is recognized. Management evaluates the recoverability of unamortized intangible assets quarterly for each acquisition using estimates of undiscounted cash flows factoring in known or expected trends, future prospects and other relevant information. If impairment is indicated, the Company measures its loss as the excess of the carrying value of the intangible assets for each Affiliate over its fair value determined using valuation models such as discounted cash flows and market comparables. Included in amortization expense for 1996 and 1995 are impairment losses of \$4,628 and \$2,500, respectively, relating to two of AMC's Affiliates following periods of significant client asset withdrawals. Fair value in such cases was determined using market comparables based on revenues, cash flow and assets under management. No impairment loss was recorded for the year ended December 31, 1997.

#### Debt Issuance Costs

Debt issuance costs incurred in securing credit facility financing are capitalized and subsequently amortized over the term of the credit facility. Unamortized debt issuance costs of \$983 and \$10,011, net of taxes, were written off as an extraordinary item in 1996 and 1997, respectively, as part of the Company's replacement of its previous credit facilities with new facilities.

#### Interest-Rate Hedging Agreements

The Company periodically enters into interest-rate hedging agreements to hedge against potential increases in interest rates on the Company's outstanding borrowings. The Company's policy is to accrue amounts receivable or payable under such agreements as reductions or increases in interest expense, respectively.

#### Income Taxes

The Company has adopted Statement of Financial Accounting Standards No. 109 ("FAS 109") which requires the use of the asset and liability approach for accounting for income taxes. Under FAS 109, the Company recognizes deferred tax assets and liabilities for the expected consequences of temporary differences between the financial statement amount and tax basis of the Company's assets and liabilities. A deferred tax valuation allowance is established if, in management's opinion, it is more likely than not that all or a portion of the Company's deferred tax assets will not be realized.

#### Foreign Currency Translation

The assets and liabilities of non-U.S. based Affiliates are translated into U.S. dollars at the exchange rates in effect as of the balance sheet date. Revenues and expenses are translated at the average monthly exchange rates then in effect.

#### Puts and Calls

As further described in Note 11, the Company periodically purchases additional equity interests in Affiliates from minority interest owners (prior shareholders of acquired Affiliates). Resulting payments made to such owners are considered purchase price for such acquired interests. The estimated cost of purchases from equity holders who have been awarded equity interests in connection with their employment is accrued, net of estimated forfeitures, over the service period as equity-based compensation.

#### Equity-Based Compensation Plans

In October 1995, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("FAS 123"). This standard became effective January 1, 1996. The standard encourages, but does not require, adoption of a fair value-based accounting method for stock-based compensation arrangements which includes stock option grants, sales of restricted stock and grants of equity-based interests in Affiliates to certain limited partners or members. An entity may continue to apply Accounting Principles Board Opinion No. 25 ("APB 25") and related interpretations, provided the entity discloses its pro forma net income and earnings per share as if the fair value based method had been applied in measuring compensation cost. The Company continues to apply APB 25 and related interpretations.



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts included in the financial statements and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

2. CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash investments and investment advisory fees receivable. The Company maintains cash and cash equivalents, short-term investments and certain off-balance-sheet financial instruments with various financial institutions. These financial institutions are located in places where AMG and its Affiliates operate. For AMG and certain Affiliates, cash deposits at a financial institution may exceed FDIC insurance limits.

Substantially all of the Company's revenues are derived from the investment management operations of its Affiliates. For the year ended December 31, 1997, one of those Affiliates accounted for approximately 33% of AMG's share of total Owners' Allocation.

3. FIXED ASSETS AND LEASE COMMITMENTS

Fixed assets consist of the following:

	At December 31,	
	1996	1997
Office equipment	\$ 2,614	\$ 5,870
Furniture and fixtures	1,677	3,530
Leasehold improvements	538	2,007
Computer software	184	760
Total fixed assets	5,013	12,167
Accumulated depreciation	(2,014)	(7,443)
Fixed assets, net	\$ 2,999	\$ 4,724

The Company and its Affiliates lease computer equipment and office space for their operations. At December 31, 1997, the Company's aggregate future minimal rentals for

operating leases having initial or noncancelable lease terms greater than one year are payable as follows:

Year Ending December 31,	Required Minimum Payments
1998	\$3,091
1999	2,735
2000	2,413
2001	2,094
2002	2,603
Thereafter	4,547

Consolidated rent expense for 1995, 1996 and 1997 was \$493, \$2,359 and \$3,637, respectively.

4. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of the following:

	At December 31,	
	1996	1997
Accounts payable	\$ 396	\$ 940
Accrued compensation	9,264	6,480
Accrued rent	3,509	2,769
Deferred revenue	796	1,481
Accrued professional services	1,350	2,552
Other	897	4,593
	\$16,212	\$18,815

5. RETIREMENT PLANS

AMG has a defined contribution retirement plan covering substantially all of its full-time employees and four of its Affiliates. Six of AMG's other Affiliates have separate defined contribution retirement plans. Under each of the plans, AMG and each Affiliate is able to make discretionary contributions to qualified plan participants up to IRS limits. Consolidated expenses related to these plans in 1995, 1996 and 1997 were \$222, \$656 and \$1,020, respectively.

6. SENIOR BANK DEBT AND SUBORDINATED DEBT

In December 1997, the Company replaced its \$300 million revolving Credit Facility with a new \$300 million revolving



credit facility ("New Credit Facility"), with principal repayment due in December 2002. Interest is payable at rates up to 1.25% over the Prime Rate or up to 2.25% over LIBOR on amounts borrowed. The Company pays a commitment fee of up to 1/2 of 1% on the daily unused portion of the facility. The Company had \$159.5 million outstanding on the New Credit Facility at December 31, 1997.

The effective interest rates on the outstanding borrowings were 6.5% and 7.2% at December 31, 1996 and 1997, respectively. All borrowings under the New Credit Facility are collateralized by pledges of all capital stock or other equity interests in each AMG Affiliate owned or to be acquired. The credit agreement contains certain financial covenants which require the Company to maintain specified minimum levels of net worth and interest coverage ratios and maximum levels of indebtedness, all as defined in the credit agreement. The credit agreement also limits the Company's ability to pay dividends and incur additional indebtedness.

As of December 31, 1997, the Company is a party, with two major commercial banks as counterparties, to \$185 million notional amount of swap contracts which are designed to limit interest rate increases on the Company's LIBOR-based borrowings. The swap contracts, upon quarterly reset dates, cap interest rates on the notional amounts at rates ranging between 6.67% and 6.78%. When LIBOR is at or below 5%, the Company's floating rate LIBOR debt is swapped for fixed rate debt at rates ranging between 6.67% and 6.78%. The hedging contracts limit the effects of the Company's payments of interest at equivalent LIBOR rates of 6.78% or less on up to \$185 million of indebtedness. The contracts mature between March 2001 and October 2002.

One of the Company's Affiliates also operates as a broker-dealer and must maintain specified minimum amounts of "net capital" as defined in SEC Rule 15c3-1. In connection with this requirement, the Affiliate has \$800 of subordinated indebtedness which qualifies as net capital under the net capital rule. The subordinated indebtedness is subordinated to claims of general creditors and is secured by notes and marketable securities of certain of the Affiliate's management members.

## 7. INCOME TAXES

A summary of the provision for income taxes, before the 1997 tax benefit of \$846 related to the extraordinary item, is as follows:

	Year Ended December 31,		
	1995	1996	1997
Federal:			
Current	\$ 60	\$ —	\$ —
Deferred	201	(233)	776
State:			
Current	514	397	352
Deferred	(69)	17	236
Provision for income taxes	\$ 706	\$ 181	\$1,364

The effective income tax rate differs from the amount computed on "income (loss) before extraordinary item" by applying the U.S. federal income tax rate because of the effect of the following items:

	Year Ended December 31,		
	1995	1996	1997
Tax at U.S. federal income tax rate	(35)%	(35)%	35%
Nondeductible expenses, primarily amortization of intangibles	54	21	15
State income taxes, net of federal benefit	13	23	13
Valuation allowance	—	6	(17)
	32%	15%	46%

The components of deferred tax assets and liabilities are as follows:

	December 31,	
	1996	1997
Deferred assets (liabilities):		
Net operating loss carryforwards	\$ 3,481	\$ 10,436
Intangible amortization	(4,950)	(9,238)
Accrued compensation	2,004	849
Other, net	(58)	(58)
	477	1,989
Valuation Allowance	(477)	(1,989)
Net deferred income taxes	\$ —	\$ —



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

At December 31, 1997, the Company had tax net operating loss ("NOL") carryforwards of approximately \$25 million which expire beginning in the year 2010. Realization is dependent on generating sufficient taxable income prior to expiration of the tax loss carryforwards. At December 31, 1997, management believed it was more likely than not that the Company's deferred tax asset of \$1,989, arising primarily from NOL carryforwards, would not be realized and accordingly established a full valuation allowance against the asset. The Company will review the valuation allowance at the end of each reporting period and will make adjustments if it is determined that it is more likely than not that the NOLs will be realized.

## 8 CONTINGENCIES

The Company and its Affiliates are subject to claims, legal proceedings and other contingencies in the ordinary course of their business activities. Each of these matters is subject to various uncertainties, and it is possible that some of these matters may be resolved unfavorably to the Company or its Affiliates. The Company and its Affiliates establish accruals for matters that are probable and can be reasonably estimated. Management believes that any liability in excess of these accruals upon the ultimate resolution of these matters will not have a material adverse effect on the consolidated financial condition or results of operations of the Company.

## 9 ACQUISITIONS AND COMMITMENTS

## 1997

During 1997, the Company acquired in purchase transactions majority interests in Gofen and Glossberg, GeoCapital and Tweedy, Browne. The Company also acquired additional interests in two of its existing Affiliates.

The Company issued 10,667 shares of Class D Convertible Preferred Stock valued at \$9.6 million as partial consideration in the GeoCapital transaction. The preferred stock was exchanged for 533,350 shares of the Company's Common Stock in connection with the Company's initial public offering.

The results of operations of Gofen and Glossberg, GeoCapital and Tweedy, Browne are included in the consolidated results of operations of the Company from their respective dates of acquisition, May 7, 1997, September 30, 1997 and October 9, 1997.

## 1996

During 1996, the Company acquired in purchase transactions majority interests in First Quadrant and Burrige. In addition, the Company acquired additional partnership interests from limited partners of two of its existing Affiliates.

On December 31, 1996, the Company issued notes in the amount of \$6.7 million as partial consideration in the purchase to Burrige selling shareholders who remained as employees. On January 3, 1997, the notes were settled in cash for \$5.2 million and the issuance of 1,715 shares of Series B-1 Voting Convertible Preferred Stock. The Convertible Preferred Stock was subsequently exchanged for 85,750 shares of Common Stock in connection with the Company's initial public offering.

The results of operations of First Quadrant and Burrige are included in the consolidated results of operations of the Company from their respective dates of acquisition, March 28, 1996 and December 31, 1996.

## 1995

During 1995, the Company acquired in purchase transactions majority interests in Systematic, Skyline and Renaissance. The Company also made a minority investment in Paradigm. In connection with an Affiliate acquisition, the Company assumed an unconditional \$3.2 million purchase obligation on the equity interests of limited partners which would be settled in either cash or the Company's stock. During 1997, the partners in that affiliate exchanged this unconditional right for new equity interests in this Affiliate.

The results of operations of Systematic, Skyline and Renaissance are included in the consolidated results of operations of the Company from their respective dates of investment, May 16, 1995, August 31, 1995, and November 9, 1995. The net income associated with the Company's minority interest in Paradigm is included in the consolidated results of operations of the Company using the equity method from May 22, 1995, the date of investment.



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The total purchase price, including cash, notes, common and preferred stock and capitalized transaction costs, associated with these investments, is allocated as follows:

	December 31,		
	1995	1996	1997
Allocation of Purchase Price:			
Net tangible assets	\$ 1,720	\$ 2,198	\$ 5,924
Intangible assets	39,800	35,040	331,421
Minority investment	888	—	—
Total purchase price	\$42,408	\$37,238	\$337,345

Unaudited pro forma data for the years ended December 31, 1996 and 1997 are set forth below, giving consideration to the acquisitions occurring in the respective two-year period, as if such transactions occurred as of the beginning of 1996, assuming revenue sharing arrangements had been in effect for the entire period and after making certain other pro forma adjustments. This pro forma data has been prepared following Accounting Principles Board Opinion No. 16 ("APB 16").

	Year Ended December 31,	
	1996	1997
Revenues	\$120,999	\$147,159
Income before extraordinary item	1,366	7,230
Extraordinary item, net	(584)	(6,141)
Net income	\$ 782	\$ 1,089
Income before extraordinary item per share – basic	\$ 0.08	\$ 0.41
Income before extraordinary item per share – diluted	0.08	0.41
Net income per share – basic	0.04	0.06
Net income per share – diluted	0.04	0.06

In conjunction with certain acquisitions, the Company has entered into agreements and is contingently liable, upon achievement of specified revenue targets over a five-year

period, beginning with the date of AMC's investment to make additional purchase payments of up to \$23 million plus interest as applicable. These contingent payments, if achieved, will be settled for cash with most coming due beginning January 1, 2001 and January 1, 2002 and will be accounted for as an adjustment to the purchase price of the Affiliate. In addition, subject to achievement of performance goals, certain key Affiliate employees have options to receive additional equity interests in their Affiliates.

Related to one of the Company's Affiliates, a former institutional shareholder is entitled to redeem a cash value warrant on April 30, 1999. Using the actual results of operations of this Affiliate to date, the cash value warrant had no value and, therefore, no amounts have been accrued in these financial statements.

# EQUITY INVESTMENT

In 1995, the Company purchased a 30% equity interest in Paradigm, which is accounted for under the equity method of accounting.

Summarized financial information for Paradigm is as follows:

	At December 31,		
	1996	1997	
Balance Sheet Data:			
Current assets	\$ 756	\$ 965	
Non current assets	492	513	
Total assets	\$ 1,248	\$ 1,478	
Current liabilities	\$ 493	\$ 416	
Non current liabilities	—	—	
Total liabilities	\$ 493	\$ 416	
	For the Period May 22, 1995 (date of acquisition) to December 31, 1995	For the Year Ended December 31, 1996	For the Year Ended December 31, 1997
Statement of Earnings Data:			
Total revenues	\$ 894	\$ 2,051	\$ 3,078
Operating and other expenses	840	1,488	2,630
Net Income	\$ 54	\$ 563	\$ 448



### 11. PUTS AND CALLS

To ensure the availability of continued ownership participation to future key employees, the Company has options to repurchase ("Calls") certain equity interests in Affiliates owned by partners or members. The options were exercisable beginning in 1997. In addition, Affiliate management owners have options ("Puts"), exercisable beginning in the Year 2000, which require the Company to purchase certain portions of their equity interests at staged intervals. The Company is also obligated to purchase ("Purchase") such equity interests in Affiliates upon death, disability or termination of employment. All of the Puts and Purchases would take place based on a multiple of the respective Affiliate's Owners' Allocation but using reduced multiples for terminations for cause or for voluntary terminations occurring prior to agreed upon dates, all as defined in the general partnership, limited partnership or limited liability company agreements of the Affiliates. Resulting payments made to former owners of acquired Affiliates are accounted for as adjustments to the purchase price for such Affiliates. Payments made to equity holders who have been awarded equity interests in connection with their employment are accrued, net of estimated forfeitures, over the service period as equity-based compensation.

The Company's contingent obligations under the Put and Purchase arrangements at December 31, 1997 ranged from \$5.3 million on the one hand, assuming all such obligations occur due to early terminations or terminations for cause, and \$145.3 million on the other hand, assuming all such obligations occur due to death, disability or terminations without cause. The Put and Purchase amounts above were calculated based upon \$20.1 million of average annual historical Owners' Allocation. Assuming the closing of all such Put and Purchase transactions, AMG would own all the prospective Owners' Allocations.

### 12. STOCKHOLDERS' EQUITY

#### Common Stock

The Company had 43,000,000 authorized shares of Common Stock (including Class B Common Stock) with a par value of \$.01 per share of which 987,500 and 17,703,617 shares were issued and outstanding at December 31, 1996 and 1997, respectively.

#### Initial Public Offering

On November 21, 1997, the Company completed an initial public offering ("IPO"), issuing 8,625,000 shares of Common Stock. In November 1997, the Company also issued 78,667 shares of Common Stock to limited partners of an Affiliate in return for equity interests in that Affiliate.

The Company's Board of Directors authorized a 50-for-1 stock split effected in the form of a stock dividend on the Company's authorized and outstanding Common Stock. The stock dividend was effective immediately prior to the Company's IPO. Where applicable, these Consolidated Financial Statements and Notes thereto reflect the Common Stock split on a retroactive basis.

#### Preferred Stock

At December 31, 1997, the Company had 5,000,000 authorized shares of preferred stock ("Preferred Stock"), par value \$.01, with no shares issued.

At December 31, 1996, the Company had two classes of convertible preferred stock ("Convertible Preferred Stock"), par value \$.01. There were 80,000 authorized and issued shares of Class A Convertible Preferred Stock. The Company also had two series of Class B Preferred Stock. There were 34,328 authorized and 14,131 issued shares of Series B-1 Voting Convertible Preferred Stock and 19,403 shares authorized and issued of Series B-2 Non-Voting Convertible Preferred Stock. During 1997, the Company issued 1,715 shares of Series B-1 Convertible Preferred Stock as partial consideration in the Burrige investment and 10,667 shares of Class D Convertible Preferred Stock in the GeoCapital investment. Also during 1997, Chase Equity Associates purchased 5,333 shares of Class C Convertible Preferred Stock and warrants to purchase 28,000 shares of Class C Convertible Preferred Stock, which were subsequently exercised. On November 21, 1997, the date of the Company's initial public offering, all issued shares of Convertible Preferred Stock, a total of 159,249 shares, were converted 1-for-50 into the Company's Common Stock, for a total of 7,962,450 common shares. At December 31, 1997 there were no shares of Convertible Preferred Stock authorized or issued.

#### Stock Incentive Plans

The Company has established three incentive stock plans ("Stock Plans"), primarily to incent key employees, under



which it is authorized to grant incentive and non-qualified stock options and to grant or sell shares of stock which are subject to certain restrictions ("Restricted Stock"). At December 31, 1997, a total of 2,300,000 shares of Common Stock have been reserved for issuance under these plans, with a total of 337,500 shares of Restricted Stock sold and 682,500 stock options granted. The plans are administered by a committee of the Board of Directors. Restricted Stock sales were made at their then fair market value, as approved by the Board of Directors of the Company, and generally vest over three years and are subject to significant forfeiture provisions and other restrictions. The exercise price of the stock options is determined by the Company's Board of Directors on the date of grant.

The 1994 Incentive Stock Plan (the "1994 Plan") provides for the issuance of 125,000 shares of Common Stock. As of December 31, 1997, the Company had sold an aggregate of 125,000 shares of Restricted Stock under the 1994 Plan. These shares vest over periods ranging up to four years. At December 31, 1997, 112,500 of these shares were vested.

The 1995 Incentive Stock Plan (the "1995 Plan") provides for the issuance of 425,000 shares of Common Stock. As of December 31, 1997, the Company had sold an aggregate 212,500 shares of Restricted Stock under the 1995 Plan. In 1997, the Company granted options to purchase 92,500 shares to officers of the Company with an exercise price of \$9.10 per share. These options vest over a three year period ending December 31, 1999. As of December 31, 1997, none of the options granted under the 1995 Plan had been exercised. The Company does not intend to make any further grants under the 1995 Plan.

The 1997 Stock Option and Incentive Plan (the "1997 Plan") provides for the issuance of 1,750,000 shares of Common Stock. In connection with the Company's initial public offering on November 21, 1997, the Company granted options to purchase 590,000 shares of Common Stock to officers and employees of the Company with an exercise price of \$23.50 per share. These options are exercisable over seven years, with 15% exercisable on each of the first six anniversaries of the date of grant and 10% exercisable on the seventh anniversary of the date of grant. The vesting period of these options will be accelerated upon a change in control of the Company or upon the achievement of certain financial goals. On December 11, 1997, the Company granted an

option to purchase 10,000 shares of Common Stock, with an exercise price of \$24.94 per share, to a newly elected director of the Company. This option becomes exercisable in equal installments of 625 shares on the first day of each calendar quarter commencing April 1, 1998. The vesting period of this option will be accelerated upon a change in control of the Company. As of December 31, 1997, none of the options granted under the 1997 Plan had been exercised.

The following is a summary of outstanding and exercisable options under the Stock Plans at December 31, 1997:

	Shares	Exercise Price (\$/Share)	Weighted Average Exercise Price (\$/Share)	Options Exercisable	Expiration Date
Options outstanding at December 31, 1996	-	-	-	-	-
Options granted	92,500	\$ 9.10		30,833	5/31/07
Options granted	590,000	\$23.50		-	11/26/07
Options granted	10,000	\$24.94		-	12/10/07
Options exercised	-	-		-	-
Options canceled	-	-		-	-
Options outstanding at December 31, 1997	692,500		\$21.60	30,833	

#### Supplemental Disclosure for Equity-Based Compensation

The Company continues to apply APB 25 and related interpretations in accounting for its sales of Restricted Stock, grants of stock options and equity-based interests in Affiliates. FAS 123 defines a fair value method of accounting for the above arrangements whose impact requires disclosure. Under the fair value method, compensation cost is measured at the grant date based on the fair value of the award and is recognized over the expected service period. The required disclosures under FAS 123 as if the Company had applied the new method of accounting are made below.

Had compensation cost for the Company's equity-based compensation arrangements been determined based on the fair value at grant date for awards subsequent to January 1, 1995, consistent with the requirements of FAS 123, the Company's net (loss) and net (loss) per share would have been as follows:



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Year Ended December 31,		
	1995	1996	1997
Net (loss) – as reported	\$ (2,936)	\$ (2,372)	\$ (8,368)
Net (loss) – FAS 123 pro forma	(3,091)	(2,141)	(8,837)
Net (loss) per share – basic – as reported	(2.95)	(5.49)	(3.69)
Net (loss) per share – basic – FAS 123 pro forma	(3.10)	(4.96)	(3.89)
Net (loss) per share – diluted – as reported	(2.95)	(5.49)	(1.02)
Net (loss) per share – diluted – FAS 123 pro forma	(3.10)	(4.96)	(1.07)

Solely for purposes of providing the pro forma disclosures required by FAS 123, the fair value of each option grant was estimated on the date of grant using the minimum value method prior to the initial public offering and the Black-Scholes option-pricing model after the offering, with the following weighted average assumptions used for grants of options.

	Year Ended December 31,	
	1995	1997
Dividend yield	0%	0%
Volatility	0%	26%
Risk-free interest rates	6.5%	5.96%
Expected option lives in years	11.3	6.7
Assumed forfeiture rate	0%	29.3%

The estimated fair value of grants of stock options and equity-based interests in Affiliates was \$2.9 million and \$4.6 million for 1995 and 1997, respectively. There were no grants in 1996.

### 13 EARNINGS (LOSS) PER SHARE

The Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 128, "Earnings per Share" ("FAS 128"). This standard became effective for financial statements issued for periods ending after December 15, 1997. The Company has adopted FAS 128 for its fiscal year ended December 31, 1997 and has restated prior-period EPS data to conform to the new standard.

The calculation for the basic earnings per share is based on the weighted average of common shares outstanding during the period. The calculation for the diluted earnings per share is based on the weighted average of common and common equivalent shares outstanding during the period, except where the inclusion of common equivalent shares has an anti-dilutive effect. Following is a reconciliation of the numerators and denominators of the basic and diluted EPS computations for "income (loss) before extraordinary item" for the three years ended December 31, 1997.

	1995	1996	1997
Numerator:			
Income (loss) before extraordinary item	\$ (2,936,000)	\$ (1,389,000)	\$ 1,643,000
Denominator:			
Average shares outstanding – basic	996,144	431,908	2,270,684
Convertible preferred stock	–	–	5,496,330
Stock options and unvested restricted stock	–	–	468,515
Average shares outstanding – diluted	996,144	431,908	8,235,529
Income (loss) before extraordinary item per share:			
Basic	\$ (2.95)	\$ (3.22)	\$ 0.72
Diluted	\$ (2.95)	\$ (3.22)	\$ 0.20

Because the computation of diluted EPS shall not assume exercise of securities that would have an anti-dilutive effect on earnings per share, as is the case in a loss year before extraordinary items, the effect of 3,512,576 and 5,585,382 outstanding shares of convertible preferred stock and 443,034 and 510,421 of unvested shares of restricted common stock were excluded from the diluted calculation in 1995 and 1996, respectively.

### 14 DISCLOSURE ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

FASB Statement of Financial Accounting Standards No. 107, "Disclosures about Fair Value of Financial Instruments" ("FAS 107"), requires the Company to disclose the estimated fair



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

values for certain of its financial instruments. Financial instruments include items such as loans, interest rate contracts, notes payable, and other items as defined in FAS 107.

Fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Quoted market prices are used when available, otherwise, management estimates fair value based on prices of financial instruments with similar characteristics or using valuation techniques such as discounted cash flow models. Valuation techniques involve uncertainties and require assumptions and judgments regarding prepayments, credit risk and discount rates. Changes in these assumptions will result in different valuation estimates. The fair value presented would not necessarily be realized in an immediate sale, nor are there plans to settle liabilities prior to contractual maturity. Additionally, FAS 107 allows companies to use a wide range of valuation techniques, therefore, it may be difficult to compare the Company's fair value information to other companies' fair value information.

The following tables present a comparison of the carrying value and estimated fair value of the Company's financial instruments at December 31, 1996 and 1997:

	December 31, 1996	
	Carrying Value	Estimated Fair Value
Financial assets:		
Cash and cash equivalents	\$ 6,767	\$ 6,767
Financial liabilities:		
Notes payable to related parties	(7,379)	(7,374)
Senior bank debt	(33,400)	(33,400)
Off-balance sheet financial instruments:		
Interest-rate hedging agreements	—	(763)

	December 31, 1997	
	Carrying Value	Estimated Fair Value
Financial assets:		
Cash and cash equivalents	\$ 23,046	\$ 23,046
Financial liabilities:		
Senior bank debt	(159,500)	(159,500)
Off-balance sheet financial instruments:		
Interest-rate hedging agreements	—	(2,528)

The carrying amount of cash and cash equivalents approximates fair value because of the short-term nature of these

instruments. The fair value of notes payable to related parties was calculated with a discounted cash flow model using existing payment terms and the prime rate. The carrying value of senior bank debt approximates fair value because the debt is a revolving credit facility with variable interest based on three-month LIBOR. The fair value of interest rate hedging agreements are quoted market prices based on the estimated amount necessary to terminate the agreements.

15. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following is a summary of the unaudited quarterly results of operations of the Company for 1996 and 1997. The amounts are in thousands except for the per share amounts.

	1996			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenues	\$ 6,756	\$12,739	\$12,675	\$18,214
Operating income	1,686	2,227	2,087	1,171
Income (loss) before income taxes and extraordinary item	1,024	(320)	291	(2,203)
Income (loss) before extraordinary item	\$ 1,196	\$ (469)	\$ (25)	\$ (2,091)
Income (loss) before extraordinary item per share – basic	\$ 3.50	\$ (1.07)	\$ (0.05)	\$ (4.33)
Income (loss) before extraordinary item per share – diluted	\$ 0.19	\$ (1.07)	\$ (0.05)	\$ (4.33)

	1997			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenues	\$16,568	\$16,302	\$20,410	\$42,007
Operating income	3,561	2,141	3,270	13,589
Income (loss) before income taxes and extraordinary item	1,220	(419)	253	1,953
Income before extraordinary item	\$ 674	\$ 32	\$ 127	\$ 810
Income before extraordinary item per share – basic	\$ 1.31	\$ 0.06	\$ 0.21	\$ 0.11
Income before extraordinary item per share – diluted	\$ 0.10	\$ —	\$ 0.02	\$ 0.07



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

During the fourth quarter of 1997, the Company completed its investment in Tweedy, Browne. The Company also completed an initial public offering of its shares of Common Stock. The Company used the net proceeds of the initial public offering to repay outstanding indebtedness and recognized an extraordinary write-off of \$10,011, net of taxes (representing \$(1.37) and \$(0.81) per share on a basic and diluted basis, respectively, from the early retirement of such indebtedness.

#### 16. EVENTS SUBSEQUENT TO DECEMBER 31, 1997

On March 20, 1998, the Company completed its investment in Essex Investment Management Company, LLC ("Essex"). The Company paid \$69.6 million in cash and the assumption of debt and 1,750,942 shares of its Class C Convertible Non-Voting Stock, \$.01 par value per share (the "Class C Stock"). Each share of Class C Stock converts into one share of Common Stock upon the earlier of March 20, 1999, or certain extraordinary events.

The total purchase price including cash, stock and capitalized transaction costs associated with this investment is allocated as follows:

Allocation of Purchase Price:	
Net tangible assets	\$ 7,408
Intangible assets	93,386
Total purchase price	\$100,794

The amortization periods used for intangible assets related to this investment are 28 years for acquired client relationships and 30 years for goodwill. Unaudited pro forma data for the years ended December 31, 1996 and 1997 are set forth below, giving consideration to the Essex investment and investments occurring in the two years ended December 31, 1997, as if such transactions had occurred as of the beginning of 1996, assuming revenue sharing arrangements had been in effect for the entire period and after making certain other pro forma adjustments. This pro forma data has been prepared following APB 16.

	Year Ended December 31,	
	1996	1997
Revenues	\$153,771	\$186,258
Income before		
extraordinary item	3,155	10,181
Extraordinary item, net	(584)	(6,141)
Net income	2,571	4,040
Income before		
extraordinary item		
per share – basic	\$ 0.16	\$ 0.53
Income before		
extraordinary item		
per share – diluted	0.16	0.52
Net income per share – basic	0.13	0.21
Net income per share – diluted	0.13	0.21

#### COMMON STOCK INFORMATION

##### MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock is traded on the New York Stock Exchange (symbol: AMG). The following table sets forth the high and low closing prices as reported on the New York Stock Exchange composite tape since the Company's initial public offering on November 21, 1997 through December 31, 1997.

1997	High	Low
Fourth Quarter (from November 21, 1997 through December 31, 1997)	\$29.875	\$24.00

The closing price for the shares on the New York Stock Exchange on March 13, 1998 was \$37.125.

As of December 31, 1997 there were 57 stockholders of record. As of March 13, 1998, there were 63 stockholders of record.

The Company has not declared a dividend with respect to the periods presented. The Company intends to retain earnings to repay debt and to finance the growth and development of its business and does not anticipate paying cash dividends on its Common Stock in the foreseeable future. The New Credit Facility (as defined herein) also prohibits the Company from making dividend payments to its stockholders. See "Management's Discussion and Analysis of Financial Condition and Results of Operation – Liquidity and Capital Resources".



## SHAREHOLDER INFORMATION

### CORPORATE OFFICES

Affiliated Managers Group, Inc.  
Two International Place  
Boston, Massachusetts 02110  
Tel: (617) 747-3300  
Fax: (617) 747-3380  
Web: [www.amg-boston.com](http://www.amg-boston.com)

### COUNSEL

Goodwin, Procter & Hoar LLP  
Boston, Massachusetts

### INDEPENDENT ACCOUNTANTS

Coopers & Lybrand L.L.P.  
Boston, Massachusetts

### TRANSFER AGENT AND REGISTRAR

Chase Mellon Shareholder Services L.L.C.  
New York, New York

### STOCK EXCHANGE LISTING

New York Stock Exchange  
Ticker Symbol: AMC

### ANNUAL MEETING

The Annual Meeting of Shareholders will be held at the offices of Goodwin, Procter & Hoar LLP, Exchange Place, Boston, Massachusetts, on May 20, 1998.

### FORM 10-K

Copies of the Company's Report on Form 10-K filed with the Securities and Exchange Commission may be obtained without charge by writing to the Company at Two International Place, Boston, Massachusetts 02110.

### BOARD OF DIRECTORS

William J. Nutt  
*President, Chief Executive Officer and  
Chairman of the Board of Directors*  
Richard E. Floor  
*Partner, Goodwin, Procter & Hoar LLP*  
Roger B. Kalker  
*Managing Director, TA Associates, Inc.*  
P. Andrews McLane  
*Senior Managing Director, TA Associates, Inc.*  
John M.B. O'Connor  
*General Partner, Chase Capital Partners*  
W.W. Walker, Jr.  
*Managing Director, NationsBank Capital Investors*  
William F. Weld  
*Partner, McDermott, Will & Emery*

### EXECUTIVE OFFICERS

William J. Nutt  
*President, Chief Executive Officer and  
Chairman of the Board of Directors*  
Sean M. Healey  
*Executive Vice President*  
Levon Chertavian, Jr.  
*Senior Vice President, Affiliate Support*  
Nathaniel Dalton  
*Senior Vice President, General Counsel and Secretary*  
Brian J. Girvan  
*Senior Vice President, Chief Financial Officer  
and Treasurer*  
Seth W. Brennan  
*Vice President*  
Jeffrey S. Murphy  
*Vice President*





AFFILIATED MANAGERS GROUP, INC.

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