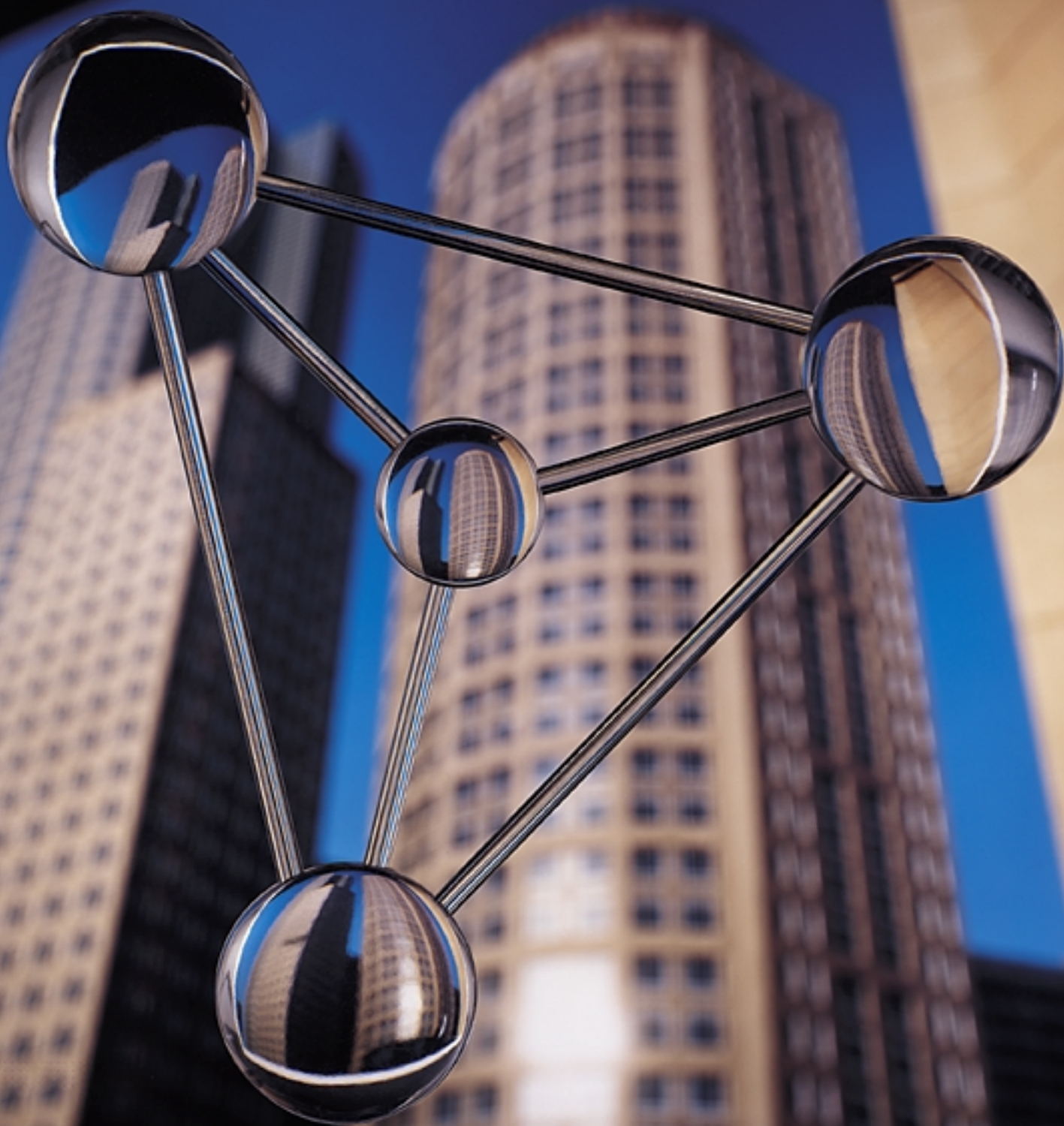


AFFILIATED MANAGERS GROUP, INC.

1998 ANNUAL REPORT



AMG 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 ITS EXISTING AFFILIATES.

## FINANCIAL HIGHLIGHTS

	1996	1997	1998	Pro Forma 1998 <sup>(3)</sup>
(in thousands, except as indicated and per share data)				
<b>STATEMENT OF OPERATIONS DATA</b>				
Revenues	\$ 50,384	\$ 95,287	\$238,494	\$278,327
Operating income	7,171	22,561	92,780	107,766
Income (loss) before extraordinary item	(1,389)	1,643	25,551	28,338
Net income (loss)	(2,372)	(8,368)	25,551	28,338
Income (loss) before extraordinary item per share – basic	\$ (3.22)	\$ 0.72	\$ 1.45	\$ 1.61
Income (loss) before extraordinary item per share – diluted	(3.22)	0.20	1.33	1.45
Net income (loss) per share – basic	(5.49)	(3.69)	1.45	1.61
Net income (loss) per share – diluted	(5.49)	(1.02)	1.33	1.45
Average shares outstanding – basic	432	2,271	17,583	17,583
Average shares outstanding – diluted	432	8,236	19,223	19,597
<b>OTHER FINANCIAL DATA</b>				
Assets under management at year end (in millions)	\$ 19,051	\$ 45,673	\$ 57,731	\$ 62,131
EBITDA <sup>(1)</sup>	10,524	20,044	76,312	89,278
EBITDA as adjusted <sup>(2)</sup>	7,596	10,201	45,675	52,724
<b>BALANCE SHEET DATA</b>				
Total assets	\$101,335	\$456,990	\$605,334	\$670,239
Senior bank debt	33,400	159,500	190,500	277,500
Total stockholders' equity	36,989	259,740	313,655	313,655

<sup>(1)</sup> EBITDA represents earnings before interest expense, 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 give effect to the investments and financing transactions which occurred during 1998 and January 1999 as if each transaction occurred as of January 1, 1998.

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## LETTER TO SHAREHOLDERS

### FELLOW SHAREHOLDERS:

Affiliated Managers Group, Inc. had an outstanding year in 1998, our first full year as a public company. Most notably, we demonstrated impressive growth in revenues, EBITDA (earnings before interest, income taxes, depreciation, amortization and extraordinary item), net income and net income per share. In addition, we welcomed three new Affiliates: Essex Investment Management Company; Davis Hamilton Jackson & Associates; and Rorer Asset Management (in early January 1999). Following the end of the year, we also completed two other important transactions. In February 1999, we significantly strengthened our capital base with our second public equity offering, and in early April we acquired The Managers Funds LLC, a mutual fund advisory firm, which gives us the ability to help our Affiliates launch mutual fund products.

Our financial results in 1998 reflect both the continued internal growth of our existing Affiliates as well as our success in making investments in new Affiliates. On a pro forma basis, EBITDA nearly doubled from \$45.0 million in 1997 to \$89.3 million in 1998 (giving effect to transactions completed during 1997 as if completed on January 1, 1997 and to transactions completed during 1998 and January 1999 as if completed on January 1, 1998 ). On a reported basis, revenues increased from \$95.3 million in 1997 to \$238.5 million in 1998, while EBITDA increased from \$20.0 million in 1997 to \$76.3 million in 1998. Finally, reported net income for 1998 totaled \$25.6 million or \$1.33 per share on a diluted basis, up substantially from net income before extraordinary item of \$1.6 million or \$0.20 per share on a diluted basis for 1997.

I am pleased to report that 1998 was a very

successful year for our company in terms of new investments. In March, Essex Investment Management Company, LLC, a leading growth equity investment firm, became our eleventh Affiliate. Essex is based in Boston and manages over \$6.0 billion in assets. During the fourth quarter of 1998, we added Davis Hamilton Jackson & Associates, L.P., an outstanding Houston-based asset manager. Davis Hamilton Jackson manages approximately \$3.5 billion of assets in large and mid-cap growth equities and fixed income securities for a variety of institutional clients. Finally, in early January 1999, we completed our investment in Rorer Asset Management, LLC. Rorer is a highly regarded Philadelphia-based investment firm that specializes in investments in large and mid-cap equities and fixed income securities, and manages over \$5.0 billion for institutional clients and high net worth individuals. We have continued this pace into 1999, with our acquisition of The Managers Funds LLC in April. Pro forma for the inclusion

of Rorer and Managers, we now have 13 Affiliates and a mutual fund subsidiary which collectively managed approximately \$64 billion at December 31, 1998.

We continue to have success in increasing awareness of the AMG approach to solving succession and continuity issues through conversations and on-site visits with the owners and principals of mid-sized firms. While these contacts include a number of introductory meetings, they are increasingly focused on

maintaining ongoing relationships with firms that are prospective Affiliates. The four investments we have completed since our initial public offering in November 1997 are all examples of our ability to convert these ongoing relationships into



*Sean Healey,  
Executive Vice  
President*

*Bill Nutt,  
Chairman, CEO  
and President*



investments in outstanding new Affiliates.

Our Affiliates continued their impressive internal growth during 1998, with assets under management increasing by \$7.2 billion on a pro forma basis. I am very proud to report that, despite the volatile market conditions during the year, as a group our Affiliates reported positive net client cash flow in directly managed assets for each quarter of 1998. We continue to believe that we are well-positioned for future internal growth, as our Affiliates manage assets across a diverse range of investment styles, asset classes and client types, with significant participation in segments which we view as having excellent growth prospects.

While we believe that our Affiliates will continue to grow on their own, we undertook several initiatives in 1998 to support and enhance their growth and operations. One example was the assistance we provided to The Burrige Group LLC in its acquisition of Sound Capital Partners, LLC. The Burrige/Sound Capital combination provides our Affiliate, Burrige, with complementary high quality products to distribute, and the Sound Capital team obtained access to Burrige's distribution and back-office support while retaining the benefits of equity ownership in their firm. AMG sourced, structured and provided financing for the transaction, and we see additional opportunities for our other Affiliates to make similar acquisitions in the future.

Looking to 1999, we view our acquisition of The Managers Funds LLC as providing us with another outstanding opportunity to support the growth of our Affiliates. This acquisition was attractive as a stand-alone investment and will also enable us to achieve an important strategic objective in the future: the ability to offer our Affiliates



SENIOR MANAGEMENT: (standing left to right) Seth Brennan, Darrell Crate, (sitting left to right) Lee Chertavian, Nate Dalton

a centralized capability to develop, administer and distribute mutual fund products. While we do not intend to change the existing funds or operations at The Managers Funds LLC, we certainly plan to use this platform to permit our Affiliates to access retail distribution channels on a cost-effective basis.

We believe we have significant opportunities to create value for our shareholders through the efficient use of our capital structure

and our strong recurring cash flow. In 1998, we used cash generated by our Affiliates primarily to support our operations, to repay debt, and to make new investments. In addition, we used the \$102 million in proceeds generated from our equity offering in early 1999 to repay debt thereby reducing our leverage. Combining that repayment with our opportunity to expand our credit facility to up to \$400 million, we feel confident in our capability to successfully continue our new investment program.

With the strong performance of our existing Affiliates, our reputation and proven ability to attract and invest in quality mid-sized firms, and the talent and experience of our management team, AMG is well-positioned for 1999 and beyond.

In closing, I would like to express our appreciation to our shareholders for their support, and thank our Affiliates, employees and outside service providers for their excellent contributions to a successful 1998.

Sincerely,

William J. Nutt  
Chairman, CEO and President

# What differentiates AMG's approach to the asset management industry?

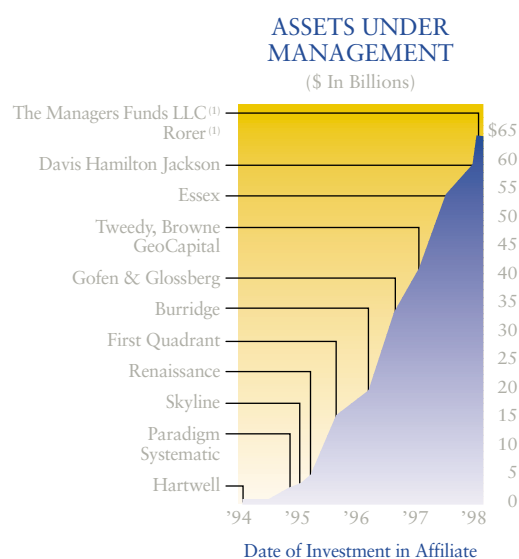


*William J. Nutt, Chairman, CEO and President. Prior to founding AMG in December 1993, Mr. Nutt was President of The Boston Company. Before joining The Boston Company in 1982, he was a partner of the law firm Ballard, Spahr, Andrews & Ingersoll.*

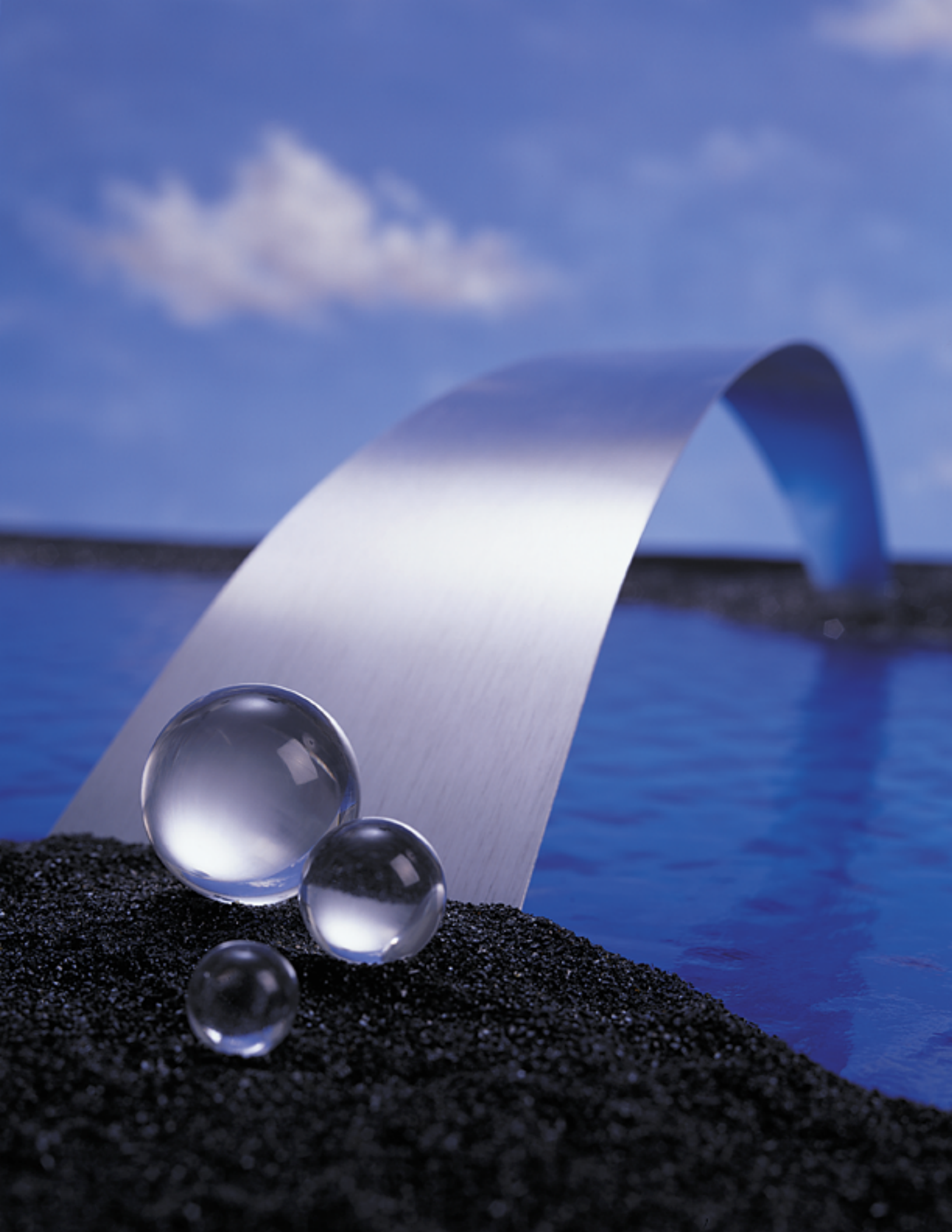
**BILL NUTT:** AMG offers a unique approach to the asset management business. AMG does not directly manage assets, but rather is a holding company which makes majority investments in growing mid-sized investment management firms. Our strategy is to generate growth through investments in new Affiliates, as well as through the internal growth of our existing Affiliates.

We have developed an innovative transaction structure which we believe is a superior succession planning alternative for growing mid-sized investment management firms. In contrast to other acquirors which typically seek 100% acquisitions, AMG makes equity investments – generally between 50% and 70% – in each of our Affiliates. By providing an opportunity for managers of each Affiliate to realize the value of their retained equity interest in the future, AMG's approach is most appealing to firms which anticipate strong future growth, and provides their managers with an ongoing equity incentive to continue to grow their firms.

**SEAN HEALEY:** We have a proven track record of successfully executing our growth strategy. Since AMG's founding in December 1993, we have invested in thirteen Affiliates and acquired a mutual fund subsidiary. Pro forma for the investment in Rorer and the acquisition of The Managers Funds LLC, assets under management have grown to approximately \$64 billion at the end of 1998. Our existing Affiliates have generated substantial internal growth, and our transaction approach has become well-recognized within our target universe of growing mid-sized investment management firms.



<sup>(1)</sup> Pro Forma as of December 31, 1998, including the investment in Rorer, which closed on January 6, 1999, and the acquisition of The Managers Funds LLC, which closed on April 1, 1999.





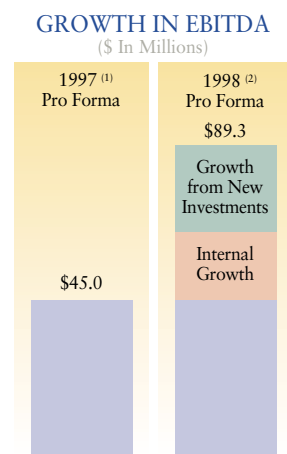




# How will AMG continue to generate earnings growth in the future?

**HEALEY:** A primary source of our expected future earnings growth is the internal growth of our existing Affiliates, both through net client cash flow and investment performance. Our Affiliates' consistent, strong net client cash flow is a key component of this internal growth – our existing Affiliates had positive aggregate net client cash flow in directly managed assets in each quarter of 1998. The second major element of our earnings growth strategy is our ongoing acquisitions of interests in new Affiliates. In the past 15 months, we added three new Affiliates – Essex Investment Management Company, LLC; Davis Hamilton Jackson & Associates, L.P.; and Rorer Asset Management, LLC – and acquired a mutual fund subsidiary, The Managers Funds LLC.

These investments in new Affiliates, along with The Managers Funds LLC, added over \$15 billion of assets under management. We believe that AMG is well-positioned to take advantage of the substantial investment opportunities within its target universe and to continue to acquire interests in growing mid-sized firms on a basis which provides accretion to future earnings.



<sup>(1)</sup> 1997 Pro Forma assumes all investments made in 1997 were made at January 1, 1997.

<sup>(2)</sup> 1998 Pro Forma assumes all investments made in 1998 and January 1999 were made at January 1, 1998.

**DARRELL CRATE:** AMG's cash flow and holding company structure provide additional sources of earnings growth. We have used moderate leverage in financing our acquisition program, so the strong recurring cash flow which AMG receives from existing Affiliate operations can be immediately used to grow earnings by lowering interest expense as we repay indebtedness. In addition, in appropriate circumstances, we can generate EPS growth by using our cash flow to repurchase our stock. Finally, our holding company structure provides an opportunity for profit margin enhancement as future incremental growth in revenues will not require commensurate increases in our holding company expenses.



*Sean M. Healey, Executive Vice President. Prior to joining AMG, Mr. Healey was a Vice President in the Mergers and Acquisitions Department at Goldman, Sachs & Co. where he had substantial experience advising clients and executing transactions in the investment management and related industries.*

# What are the objectives of AMG's acquisition strategy?

**SETH BRENNAN:** AMG seeks to acquire interests in growing, high-quality firms which have outstanding management teams and superior future prospects. With 14 transactions in the past four years, we have a proven record of successfully executing our acquisition strategy.

The implementation of our strategy begins with a highly organized calling effort designed to introduce AMG's approach as a succession planning solution to our target universe of 1,300 mid-sized investment firms in the U.S., U.K. and Canada with assets under management between \$500 million and \$10 billion.

We believe that a large number of the principals of these firms are approaching retirement age and seeking a succession planning solution for themselves and their firms. We have identified over 750 of the firms in our target universe as potential AMG Affiliates, have visited over 440 firms from that group, and seek to maintain ongoing relationships with the most promising of those firms. The relationships formed from this calling effort represent the most important source of AMG's future new investments.

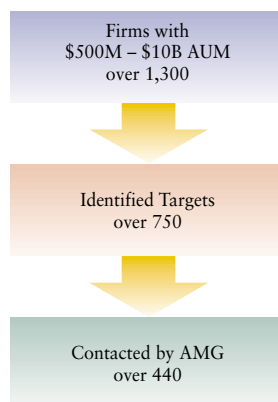


*Seth W. Brennan, Vice President. Prior to joining AMG, Mr. Brennan was in the Financial Institution Groups at Morgan Stanley & Co. and Wasserstein, Perella & Co., where he advised investment management firms, insurance companies, and other diversified financial institutions.*



*Nathaniel Dalton, Senior Vice President and General Counsel. Prior to joining AMG, Mr. Dalton was an attorney at Goodwin, Procter & Hoar LLP, focusing on mergers and acquisitions, including those in the asset management industry.*

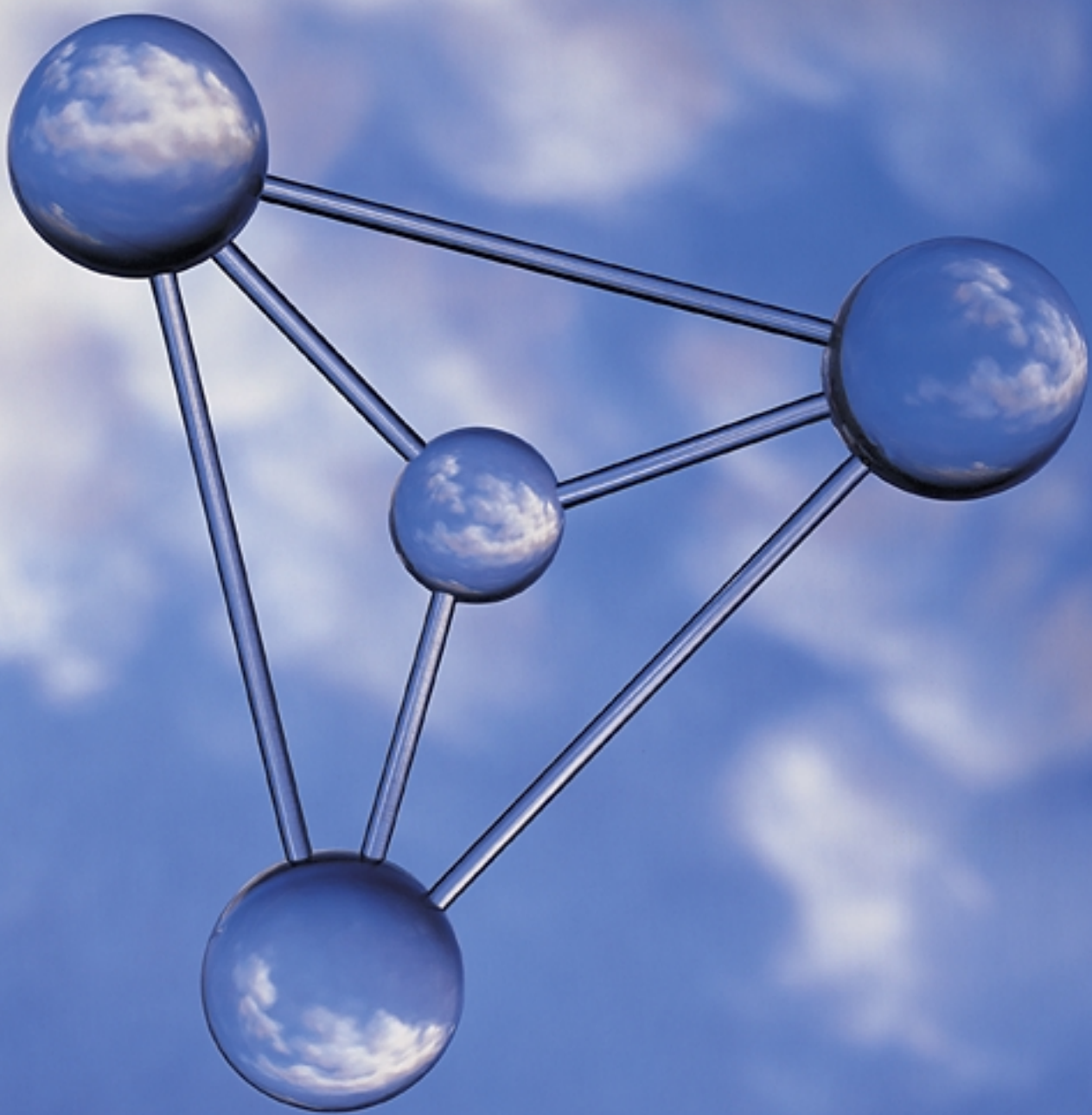
## AMG TARGET UNIVERSE



**NATE DALTON:** The AMG structure is designed to appeal to growing firms and to incent and reward future growth. AMG offers a long-term solution to a firm's succession issues, in which we provide for direct retained equity post-transaction. This retained equity will grow in value as the firm grows, and individual members of management of our Affiliates will have the opportunity to sell this ownership to AMG in the future. Because the AMG structure aligns the incentives of our Affiliates' management owners with AMG's incentives, we also provide the management owners of each Affiliate with autonomy over the day-to-day operations of their firm. Since we couple the equity incentives and operational autonomy of our structure with strategic assistance, AMG is a natural choice for growing firms which seek an equity partner to address succession issues.







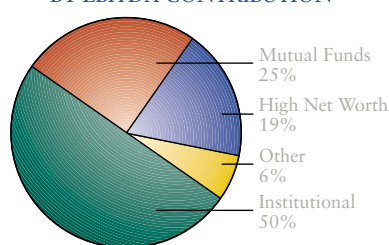
# How do AMG's cash flow and capital structure support future growth?

**C R A T E :** The strong, recurring cash flow which AMG receives from our existing Affiliates supports AMG's earnings growth by allowing us to fund our acquisition program, to repay existing debt, or, when appropriate, to repurchase AMG's stock. It is important to understand the extent to which AMG's reported net income differs from its after-tax cash flow. Because we have used the purchase method of accounting for our investments, AMG's financial results include substantial non-cash charges for depreciation and amortization of intangible assets. To illustrate, while 1998 pro forma net income was \$28.3 million, net income plus these non-cash items (EBITDA as adjusted) on the same basis was \$52.7 million, or 86% higher. In addition, AMG has historically achieved substantial growth in its cash flow from existing Affiliates – pro forma 1998 EBITDA as adjusted was 97% higher than pro forma 1997 EBITDA as adjusted.



*Darrell W. Crate, Senior Vice President and Chief Financial Officer. Prior to joining AMG, Mr. Crate was a Managing Director at The Chase Manhattan Corporation focusing on investment management firms. Most recently, Mr. Crate was based in London and responsible for clients in the United Kingdom, France, Germany, Italy and Spain.*

**CLIENT TYPE  
BY EBITDA CONTRIBUTION<sup>(1)</sup>**

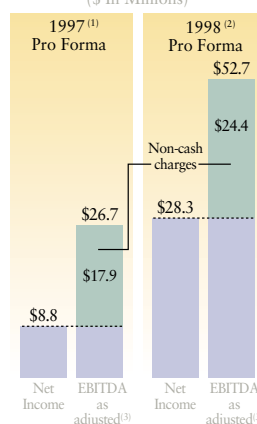


<sup>(1)</sup> Pro Forma 1998. Assumes all investments made in 1998 and January 1999 were made at January 1, 1998.

**N U T T :** It also is important to appreciate the diversity of AMG's cash flow from existing Affiliates. Measured by the contribution to AMG's EBITDA, AMG's cash flow has broad diversity among the asset classes (including domestic and international), investment styles, client types and distribution channels. This breadth of contribution from different sectors of the asset management industry provides additional stability to AMG's cash flow by limiting our exposure to the volatility of any individual industry segment.

**C R A T E :** We have also supported future earnings growth by managing AMG's capital structure to provide ample capacity to fund our new investment program, while enhancing our return on equity with the use of moderate financial leverage. Following the completion of our most recent equity offering in February 1999, we had up to \$225 million of additional borrowing capacity available under our senior bank facility on terms which we believe are very favorable. In addition, as a publicly traded company, we also have the option of using stock as consideration in transactions.

**NET INCOME &  
EBITDA AS ADJUSTED**  
(\$ In Millions)



<sup>(1)</sup> 1997 Pro Forma assumes all investments and financing transactions made in 1997 were made at January 1, 1997.

<sup>(2)</sup> 1998 Pro Forma assumes all investments and financing transactions made in 1998 and January 1999 were made at January 1, 1998.

<sup>(3)</sup> "EBITDA as adjusted" represents earnings after interest expense and income taxes but before depreciation, amortization and extraordinary item.

# How do Affiliates benefit post-transaction?



*Lee Chertavian, Senior Vice President. Prior to joining AMG, Mr. Chertavian was President of USAffinity Investments, the mutual fund operation of Trans National Group. Before Trans National, Mr. Chertavian held positions with Bain & Company, Fidelity Investments, Bankers Trust Company and Equitable Life.*

**LEE CHERTAVIAN:** Following an investment by AMG, our primary goal is to maintain the incentives and structure, including direct equity ownership, that have enabled the Affiliate to achieve the growth that attracted us to them in the first place. Within this structure, we try to provide our Affiliates with access to opportunities, benefits and cost-savings that are typically not available to mid-sized investment management firms. This support is generally provided at the request of the Affiliate, as we believe our management partners are in the best position to determine the needs of their business, and our structure is designed to align their economic incentives with ours.

#### AFFILIATE SUPPORT

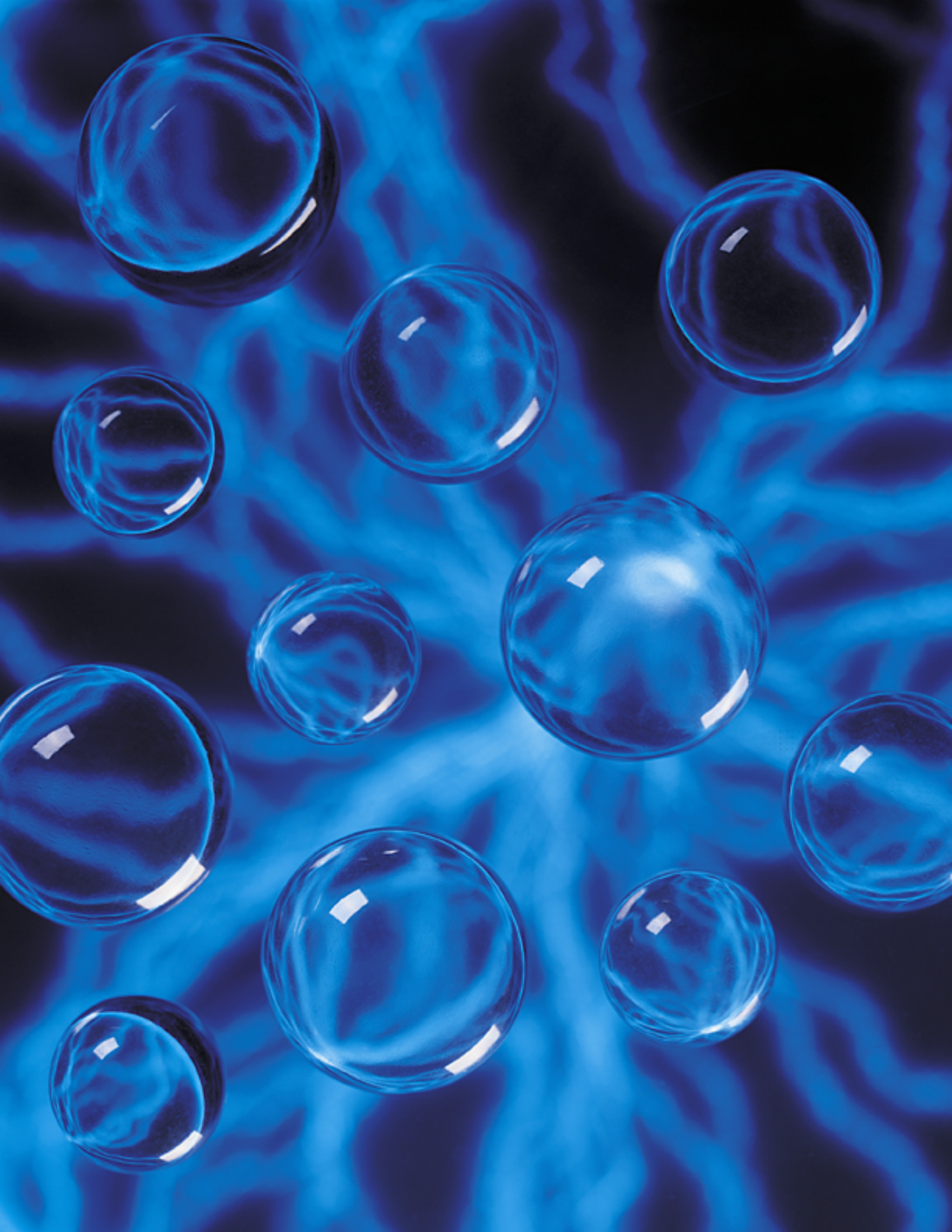
- Strategic Assistance
- Marketing and Distribution
- Operational Efficiency

AMG's support falls into three general categories: strategic assistance, marketing and distribution, and operational efficiency. Support initiatives for individual Affiliates are tailored to the specific needs of that Affiliate. Examples of such projects during the past few years include planning new product introductions, providing guidance on technology solutions, developing entry plans for new distribution channels, hiring key management personnel and assessing compensation systems. With our acquisition of The Managers Funds LLC, we now also have a significant opportunity to provide our Affiliates with cost-effective access to retail distribution channels.

**DALTON:** One of the most important ways we can assist Affiliates to grow is in their acquisition of new products and lines of business. We frequently identify firms and teams of managers which are not suitable for a stand-alone AMG investment but which have outstanding investment processes, excellent track records, and/or solid, if smaller, bases of clients. Combining such a firm or team with an AMG Affiliate which has incremental distribution and back-office capacity provides a compelling growth opportunity for the Affiliate.

These transactions take many forms, from lifting out a team to a true acquisition by an Affiliate. In each case, the experience of our management team and the flexibility of our structure allow our Affiliates to compete for teams with extraordinary performance records. For example, this year we sourced, structured and financed the acquisition of Seattle-based Sound Capital Partners, LLC by our Affiliate, The Burrige Group LLC. Burrige, which had additional capacity in their distribution system, now has complementary products with excellent long-term track records.





## AFFILIATES AND MUTUAL FUND SUBSIDIARY

### AFFILIATES

#### THE BURRIDGE GROUP LLC

The Burridge Group, founded in 1986, specializes in the management of mid and large-cap growth equity portfolios. Burridge's clients include corporate, Taft-Hartley and public pension plans, as well as foundations, endowments and individuals. The firm has two distinct investment teams, a Chicago-based team which manages its mid-cap portfolios, and a Seattle-based team which manages its large-cap portfolios.

#### DAVIS HAMILTON JACKSON & ASSOCIATES, L.P.

DHJA is an investment adviser which specializes in investing in large and mid-cap growth equities and fixed income securities. Based in Houston, the firm offers three types of investment products: equity, fixed income, and balanced. DHJA's clients primarily include pension and profit sharing plans for public and private entities and corporations, with a particular focus on public fund business in the Southeast. In addition, the company manages accounts for endowments, foundations and several Taft-Hartley plans, and sub-advises a mutual fund.

#### 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.

Pasadena-based First Quadrant, L.P., together with its London-based sister company First Quadrant Limited, specialize in asset allocation and style management on a global basis. Employing a highly disciplined quantitative methodology to

guide its investment strategy, First Quadrant seeks to add value by assessing relative valuations across major segments of the portfolio: among asset classes, across global markets, among equity styles and in currency allocation. First Quadrant provides its services to large domestic and international corporate and public pension plans, foundations and endowments.

#### 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. Founded in 1932, 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 encourage consistent capital growth.

#### J.M. HARTWELL LIMITED PARTNERSHIP

Founded in 1961, Hartwell is a New York-based growth stock manager whose clients include high net worth individuals, an offshore hedge fund, and several private foundations. The firm uses a disciplined selection process to identify stocks of companies with strong fundamentals and exposure to long-term trends. The portfolio style is one of long-term investing which has a particular appeal to taxable accounts.

#### 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 employing its 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.

#### RORER ASSET MANAGEMENT, LLC\*

A Philadelphia-based investment adviser, Rorer specializes in investing in large and mid-cap equities and fixed income securities for both institutional and individual clients. Rorer employs a highly disciplined relative value investment process engineered by its founder to reduce performance volatility while achieving superior market returns. The firm offers four types of investment accounts – large-cap equity, mid-cap equity, balanced, and fixed income – to its diverse client base of individuals, trusts, estates, corporations, pension and profit sharing plans, charitable institutions, and union and Taft-Hartley funds.

#### SKYLINE ASSET MANAGEMENT, L.P.

Skyline is a Chicago-based investment advisory firm which specializes in small-capitalization value equities. Skyline uses a bottom-up investment philosophy, which is supported by fundamental in-house research to provide clients with three distinct small-cap value styles. Skyline manages assets for institutional clients as well as three no-load mutual funds – *Skyline Special Equities*, *Skyline Small-Cap Value Plus*, and the *Skyline Small-Cap Contrarian*.

#### 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 equities and free cash flow value equity.

#### TWEEDY, BROWNE COMPANY LLC

Tweedy, Browne is a leading practitioner of the value-oriented investment approach first advocated by Benjamin Graham. Based in New York, 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*.

#### MUTUAL FUND SUBSIDIARY

#### THE MANAGERS FUNDS LLC\*\*

The Managers Funds LLC, located in Norwalk, Connecticut, is the adviser to a no-load fund family comprised of ten equity and fixed income mutual funds. The Managers Funds LLC employs an innovative business model whereby it selects sub-advisers for its mutual fund products from a universe of over one thousand investment managers. The mutual funds advised by The Managers Funds are distributed to retail and institutional clients directly and through intermediaries including independent investment advisers, 401(k) plan sponsors and alliances, broker-dealers, major fund marketplaces, and bank trust departments.

\* AMG completed its investment in Rorer on January 6, 1999.

\*\* AMG completed its acquisition of The Managers Funds LLC on April 1, 1999.



## FINANCIAL INFORMATION INDEX \*

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*\* All information in this section was filed with the Securities and Exchange Commission on March 31, 1999 on the Company's Form 10-K. This information has not been updated for events which occurred after that date.*

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

## ◆ FORWARD-LOOKING STATEMENTS

When used in this Annual Report and in our future filings with the Securities and Exchange Commission, in our 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-Cautious Statements”, which are set forth in our 1998 Form 10-K, that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. We wish to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. We wish to advise readers that the factors under the caption “Business-Cautious Statements” in the 1998 Form 10-K could affect our financial performance and could cause our actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements.

In addition, the discussion and analysis with respect to the Year 2000 Issue, including (i) our expectations of when Year 2000 compliance will actually be achieved, (ii) estimates of the costs involved in achieving Year 2000 readiness and (iii) our belief that the costs will not be material to operating results are based on management's estimates which, in turn, are based upon a number of assumptions regarding future events, including third party modification plans and the availability of certain resources. There can be no guarantee that these estimates will be achieved, and actual results may differ materially from management's estimates. Specific factors which might cause such material differences with respect to the Year 2000 Issue include, but are not limited to, the failure of third party providers to achieve represented or stated levels of Year 2000 compliance, availability and cost of personnel trained in this area, the ability to locate and correct all relevant computer codes, and similar uncertainties.

We will not undertake and we specifically disclaim 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 events, whether or not anticipated.

## ◆ OVERVIEW

We acquire equity interests in mid-sized investment management firms and currently derive all of our revenues from those firms. We refer to firms in which we have purchased less than 100% (typically less than 80%) as our “affiliates”. We hold investments in 13 affiliates that managed \$62.1 billion in assets at December 31, 1998. Our most recent affiliate investments were in Essex (March 1998), Davis Hamilton Jackson (December 1998) and Rorer (January 1999). On January 29, 1999, we entered into a definitive agreement to acquire substantially all of the partnership interests in the Managers Funds, L.P. (“Managers”), which serves as the adviser to a family of ten equity and fixed income no-load mutual funds. These mutual funds had a total of \$1.8 billion in assets under management at December 31, 1998.

We have a revenue sharing arrangement with each of our affiliates which allocates a specified percentage of revenues (typically 50-70%) for use by management of that affiliate in paying operating expenses, 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 AMG), generally in proportion to their ownership of the affiliate. One of the purposes of our revenue sharing arrangements is to provide ongoing incentives for the managers of the affiliates by allowing them:

- to participate in their firm's growth through their compensation from the Operating Allocation,
- to receive a portion of the Owners' Allocation based on their ownership interest in the affiliate, and
- to control operating expenses, thereby increasing the portion of the Operating Allocation which is available for growth initiatives and bonuses for management of the affiliate.

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

The managers of each affiliate, therefore, have an incentive to both increase revenues (thereby increasing the Operating Allocation and their Owners' Allocation) and to control expenses (thereby increasing the excess Operating Allocation).

The revenue sharing arrangements allow us to participate in the revenue growth of each affiliate because we receive a portion of the additional revenue as our share of the Owners' Allocation. However, we participate in that growth to a lesser extent than the managers of the affiliate, because we do not share in the growth of the Operating Allocation.

Under the organizational documents of the affiliates, the allocations and distributions of cash to us generally take priority over the allocations and distributions to the management owners of the affiliates. This further protects us if there are any expenses in excess of the Operating Allocation of an affiliate. Thus, if an affiliate's expenses exceed its Operating Allocation, the excess expenses first reduce the portion of the Owners' Allocation allocated to the affiliate's management owners, until that portion is eliminated, and then reduce the portion allocated to us.

The portion of each affiliate's revenues which is included in its Operating Allocation and retained by it 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 us and the other owners of the affiliate, are both included as "revenues" on our Consolidated Statements of Operations. The expenses of each affiliate which are paid out of the Operating Allocation, as well as our holding company expenses which we pay out of the amounts of the Owners' Allocation which we receive from the affiliates, are both included in "operating expenses" on our Consolidated Statements of Operations. The portion of each affiliate's Owners' Allocation which is allocated to owners of the affiliates other than us is included in "minority interest" on our Consolidated Statements of Operations.

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

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; these performance-based fees 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.

Our 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 our existing 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 we finance our investments; (iv) our success in attracting new investments and the terms upon which such transactions are completed; (v) the level of intangible assets and the associated amortization expense resulting from our investments; (vi) the level of expenses incurred for holding company operations, including compensation for our employees; and (vii) the level of taxation to which we are subject, all of which are, to some extent, dependent on factors which are not in our control, such



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

as general securities market conditions.

Assets under management on a historical basis increased by \$12.0 billion to \$57.7 billion at December 31, 1998 from \$45.7 billion at December 31, 1997, in part due to the investments made in Essex and DHJA during 1998. Excluding the initial assets under management at the dates of these investments, assets under management increased by \$3.8 billion as a result of \$3.6 billion in market appreciation and \$159.6 million from net client cash flows. Excluding assets managed using "overlay" strategies (which generally carry fees at the lower end of the range of fees for directly managed assets), assets increased by \$1.7 billion for the year. Assets indirectly managed using such "overlay" strategies declined by \$1.6 billion for the year.

Our investments have been accounted for under 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 our investments, intangible assets, consisting of acquired client relationships and goodwill, constitute a substantial percentage of our consolidated assets and our results of operations have included increased charges for amortization of those intangible assets. As of December 31, 1998, our total assets were approximately \$605.3 million, of which approximately \$169.1 million consisted of acquired client relationships and \$321.4 million consisted of goodwill.

The amortization period for intangible assets for each investment is assessed individually, with amortization periods for our investments to date ranging from nine to 28 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, we consider a number of factors including: the firm's historical and potential future operating performance and rate 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. We perform a quarterly evaluation of

intangible assets on an affiliate-by-affiliate basis to determine whether there has been any impairment in their carrying value or their useful lives. 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 our 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 our distributions from our affiliates are based on their Owners' Allocation, management has provided additional supplemental information in this 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 expense, income taxes, depreciation, amortization and extraordinary item), which we believe is useful to investors as an indicator of our ability to service debt, to make new investments, and to meet working capital requirements, and (ii) EBITDA as adjusted (earnings after interest expense and income taxes, but before depreciation, amortization and extraordinary item), which we believe is useful to investors as another indicator of funds available which may be used to make new investments, to repay debt obligations, to repurchase shares of our Common Stock, or to pay dividends on our Common Stock.

### ◆ RESULTS OF OPERATIONS

#### SUPPLEMENTAL PRO FORMA INFORMATION

Affiliate operations are included in our historical financial statements from their respective dates of acquisition. We consolidate affiliates when we own a controlling interest and include in minority interest the portion of capital and Owners' Allocation owned by persons other than us.

Because we have made investments in each of the periods for which financial statements are presented, we believe that the operating results for these periods are not directly comparable. Substantially all of the changes in our income, expense and balance sheet categories result from the inclusion of the acquired businesses from the dates of our investments in them. Therefore, we have

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

provided the following pro forma data, which should be read with our consolidated financial statements and the notes to such statements, which are included elsewhere in this report.

All amounts below are pro forma for the inclusion of the Essex, DHJA and Rorer investments as if such transactions occurred on January 1, 1998.

## UNAUDITED PRO FORMA SUPPLEMENTAL INFORMATION

(in millions) December 31, 1998

Assets under Management – at period end:	
Tweedy, Browne	\$ 6,641
Other Affiliates	55,490
Total	\$ 62,131

(in thousands) Year Ended  
December 31, 1998

Revenues:	
Tweedy, Browne	\$ 78,243
Other Affiliates	200,084
Total	\$278,327

Owners' Allocation <sup>(1)</sup> :	
Tweedy, Browne	\$ 54,097
Other Affiliates <sup>(2)</sup>	88,936
Total	\$143,033

EBITDA Contribution <sup>(1)</sup> :	
Tweedy, Browne	\$ 39,284
Other Affiliates <sup>(3)</sup>	57,642
Total	\$ 96,926

### Other Pro Forma Financial Data:

#### Reconciliation of EBITDA

Contribution to EBITDA	
Total EBITDA Contribution (as above)	\$ 96,926
Less holding company expenses	(7,648)
EBITDA <sup>(1)</sup>	\$ 89,278
EBITDA as adjusted <sup>(1)</sup>	\$ 52,724

(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 24% of Owners' Allocation for the year ended December 31, 1998.

(3) No Affiliate other than Tweedy, Browne accounted for more than 25% of EBITDA Contribution for the year ended December 31, 1998.

### Other Historical Cash Flow Data:

Cash flow from operating activities	\$ 45,424
Cash flow used in investing activities	(72,665)
Cash flow from financing activities	28,163
EBITDA <sup>(1)</sup>	76,312
EBITDA as adjusted <sup>(1)</sup>	45,675

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

The table below depicts the pro forma change in our assets under management giving effect to all investments made as of December 31, 1998 and the Rorer investment completed on January 6, 1999 as if such investments occurred on January 1, 1998.

(in millions)	Year Ended December 31, 1998
Assets under management – beginning	\$54,961
Net new sales	2,001
Market appreciation	5,169
Assets under management – ending	\$62,131

## ♦ HISTORICAL

### YEAR ENDED DECEMBER 31, 1998 AS COMPARED TO YEAR ENDED DECEMBER 31, 1997

We had net income of \$25.6 million for the year ended December 31, 1998 compared to net income before extraordinary item of \$1.6 million for the year ended December 31, 1997. The increase in net income resulted substantially from net income from new investments. We invested in Gofen and Glossberg in May 1997, GeoCapital in September 1997, Tweedy, Browne in October 1997, and Essex in March 1998 (collectively, the "New Affiliates") and included their results from their respective dates of investment. Our net loss after extraordinary item of \$8.4 million for the year ended December 31, 1997 resulted from a \$10.0 million extraordinary item, net of related tax benefit, from the write-off of debt issuance costs related to the early extinguishment of debt.

Revenues for the year ended December 31, 1998 were \$238.5 million, an increase of \$143.2 million over the year ended December 31, 1997. Such increase was primarily a result of the addition of the New Affiliates.

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

Performance-based fees earned by our affiliates remained approximately 18% of revenues, increasing \$26.8 million to \$44.0 million for the year ended December 31, 1998 compared to \$17.2 million for the year ended December 31, 1997, primarily as a result of the addition of the New Affiliates.

Operating expenses increased by \$73.0 million to \$145.7 million for the year ended December 31, 1998 over the year ended December 31, 1997. Compensation and related expenses increased by \$46.1 million to \$87.7 million, amortization of intangible assets increased by \$10.8 million to \$17.4 million, selling, general and administrative expenses increased by \$12.7 million to \$31.6 million, and other operating expenses increased by \$2.6 million to \$6.3 million. The growth in operating expenses was primarily a result of the addition of the New Affiliates.

Minority interest increased by \$26.6 million to \$38.8 million for the year ended December 31, 1998 over the year ended December 31, 1997, primarily as a result of the addition of the New Affiliates.

Interest expense increased by \$5.1 million to \$13.6 million for the year ended December 31, 1998 over the year ended December 31, 1997, as a result of the increased indebtedness incurred in connection with the investments in the New Affiliates.

Income tax expense was \$17.0 million for the year ended December 31, 1998 compared to \$1.4 million for the year ended December 31, 1997. The change in income tax expense is principally related to the increase in income before taxes in the year ended December 31, 1998.

EBITDA increased by \$56.3 million to \$76.3 million for the year ended December 31, 1998 over the year ended December 31, 1997, primarily as a result of the inclusion of the New Affiliates.

EBITDA as adjusted increased by \$35.5 million to \$45.7 million for the year ended December 31, 1998 over the year ended December 31, 1997 as a result of the factors affecting net income as described above, before non-cash expenses such as amortization of intangible assets and depreciation of \$20.1 million for the year ended December 31, 1998.

### YEAR ENDED DECEMBER 31, 1997 AS COMPARED TO YEAR ENDED DECEMBER 31, 1996

We had a net loss of \$8.4 million for the year ended December 31, 1997 compared to a net loss 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.

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. We invested in BurrIDGE 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, we 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, BurrIDGE, 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



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Quadrant, BurrIDGE, 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, BurrIDGE, 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 our selling, general and administrative expenses as well as our other affiliates.

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 our 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 indebtedness incurred in connection with the investments described above.

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, we recorded a federal deferred tax benefit of \$233,000 on a pretax loss of \$1.2 million. In 1997, we 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.

### ◆ LIQUIDITY AND CAPITAL RESOURCES

We have met our cash requirements primarily through cash generated by operating activities, bank borrowings, and the issuance of equity and debt securities in public and private placement transactions. We anticipate that we will use cash flow from our operating activities to repay debt and to finance our working capital needs and will use bank borrowings and issue equity and debt securities to finance future affiliate investments. Our principal uses of cash have been to make investments in affiliates, to retire indebtedness, repurchase shares and to support our and our affiliates' operating activities. We expect that our 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 us, additional investments in existing affiliates, including upon management owners' sales of their retained equity to us, and for working capital purposes. We do not expect to make commitments for material capital expenditures.

At December 31, 1998, we had outstanding borrowings of senior debt under our credit facility of \$190.5 million. On January 29, 1999 we exercised our option to expand the credit facility from \$300 to \$330 million and added another major commercial bank to our group of lenders. We have the option, with the consent of our lenders, to increase the facility by another \$70 million

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

to a total of \$400 million. Our credit facility bears interest at either LIBOR plus a margin ranging from .50% to 2.25% or the Prime Rate plus a margin ranging up to 1.25% and matures during December 2002. In order to offset our exposure to changing interest rates we enter into interest rate hedging contracts. See "Interest Rate Hedging Contracts". We pay a commitment fee of up to 1/2 of 1% on the daily unused portion of the facility.

Our borrowings under the credit facility are collateralized by pledges of all of our interests in affiliates (including all interests in affiliates which are directly held by us, as well as all interests in affiliates which are indirectly held by us through wholly-owned subsidiaries), which interests represent substantially all of our assets. Our credit facility contains a number of negative covenants, including those which generally prevent us and our affiliates from: (i) incurring additional indebtedness (other than subordinated indebtedness), (ii) creating any liens or encumbrances on material assets (with certain enumerated exceptions), (iii) selling assets outside the ordinary course of business or making certain fundamental changes with respect to our businesses, including a restriction on our ability to transfer interests in any majority owned affiliate if, as a result of such transfer, we would own less than 51% of such affiliate, and (iv) declaring or paying dividends on our Common Stock.

In order to provide the funds necessary for us to continue to acquire interests in investment management firms, including our existing affiliates upon the management owners' sales of their retained equity to us, it will be necessary for us 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 us.

Net cash flow from operating activities was \$45.4 million, \$16.2 million and \$6.2 million for the years ended December 31, 1998, 1997 and 1996, respectively. The increase in net cash flow from operating activities from 1997 to 1998 was principally due to our investments in new affiliates in 1997 and 1998.

Net cash flow used in investing activities was \$72.7 million, \$327.3 million and \$29.2 million for the years

ended December 31, 1998, 1997 and 1996, respectively. Of these amounts, \$66.1 million, \$325.9 million, and \$25.6 million, respectively, were used to make investments in affiliates.

On March 20, 1998, we acquired a majority interest in Essex. We paid \$69.6 million in cash, in addition to 1,750,942 newly-issued shares of our Series C Convertible Non-Voting Stock which converted into an equal number of shares of Common Stock on March 20, 1999. The Company funded the cash portion of this investment with borrowings under its credit facility.

On December 31, 1998, we acquired a 65% interest in DHJA. DHJA is a Houston based asset management firm with approximately \$3.5 billion of assets under management at December 31, 1998. On January 6, 1999, we acquired an approximately 65% interest in Rorer. Rorer is a Philadelphia based investment adviser with approximately \$4.4 billion of assets under management at December 31, 1998. We paid \$65 million in cash for our investment in Rorer. We financed these two investments with borrowings under our credit facility.

On January 29, 1999, we entered into a definitive agreement to acquire substantially all of the partnership interests in The Managers Funds, L.P., which serves as the adviser to a family of ten equity and fixed income no-load mutual funds. These mutual funds had a total of \$1.8 billion in assets under management at December 31, 1998. This transaction is subject to customary closing conditions. We intend to finance the investment with a borrowing under our credit facility.

Net cash flow from financing activities was \$28.2 million, \$327.1 million and \$15.7 million for the years ended December 31, 1998, 1997 and 1996. The principal sources of cash from financing activities has been from borrowings under senior credit facilities and subordinated debt, private placements of our equity securities and our initial public offering. 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.

On September 11, 1998, our Board of Directors authorized a share repurchase program pursuant to which

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

we could repurchase up to five percent of our issued and outstanding shares of Common Stock. Through December 31, 1998, we purchased 147,000 shares of Common Stock for \$2.6 million.

On March 3, 1999, we completed a public offering of 5,529,954 shares of Common Stock, of which 4,000,000 shares were sold by us and 1,529,954 shares were sold by selling stockholders. We used the net proceeds from the 4,000,000 shares sold by us to reduce indebtedness and did not receive any proceeds from the sale of Common Stock by the selling stockholders.

### ◆ YEAR 2000

The "Year 2000" poses a concern to our business as a result of the fact that computer applications have historically used the last two digits, rather than all four digits, to store year data. If left unmodified, these applications would misinterpret the Year 2000 for the Year 1900 and would in many cases be unable to function properly in the Year 2000 and beyond.

We have based our evaluation of our ability to prepare for the Year 2000 upon a number of assumptions regarding future events, including third party modification plans and the availability of needed resources. We cannot guarantee that these estimates will be achieved, and actual results may differ materially from our estimates. Specific factors which might cause such material differences with respect to the Year 2000 issue include, but are not limited to, the failure of our affiliates to achieve represented or stated levels of Year 2000 compliance, the availability and cost of personnel trained in this area, and the ability to locate and correct all relevant computer codes and similar uncertainties.

### AMG'S READINESS

In anticipation of this problem, we have identified all of the significant computers, software applications and related equipment used at our holding company that need to be modified, upgraded or replaced to minimize the possibility of a material disruption to our business based on the advent of the Year 2000. We anticipate completing our Year 2000 preparations at the holding company by the end of the second quarter of 1999. We estimate

our total cost will be less than \$800,000 for the four year period ending on December 31, 1999. We cannot be certain that we will not encounter unforeseen delays or costs in completing our preparations.

### OUR AFFILIATES' READINESS

We have also established a time line with each of our affiliates to complete their Year 2000 preparations and have received estimates from each of them of the costs required to complete their preparations. As part of our general preparedness program, each of our affiliates has assigned responsibility for preparing for the Year 2000 to a member of its senior management in order to ensure that both proprietary and third party vendor systems will be ready for the Year 2000. Each of our affiliates has completed its assessment and plans are in place for the renovation or replacement of all non-compatible systems. We anticipate that the affiliates will complete the renovation or replacement of all non-compatible systems and the subsequent testing of all systems by the end of the second quarter of 1999. Most of our affiliates pay for the costs of their Year 2000 preparations out of their operating allocation, which is the portion of their revenues that is allocated to pay their operating expenses. As a result, these costs will only reduce an affiliate's distributions to us based on our ownership interest in the affiliate if the affiliate's operating expenses exceed its operating allocation and the portion of revenues allocated to the management owners.

### OUTSIDE SERVICE PROVIDERS

Outside service providers perform several processes which are critical to our affiliates' business operations, including transfer agency and custody functions. Our affiliates have surveyed these parties and are monitoring their progress. However, our affiliates have limited control, if any, over the actions of these outside parties and in some instances have no alternative vendors. If outside service providers fail to resolve their Year 2000 issues, we anticipate that our affiliates' operations will experience material disruptions caused by the inability to process trades and access client and investment research data files and, accordingly, our and our affiliates' businesses would be adversely affected.



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

### ◆ INTEREST RATE SENSITIVITY

Our revenues are derived primarily from fees which are based on the values of assets managed. Such values are affected by changes in the broader financial markets which are, in part, affected by changing interest rates. We cannot predict the effects that interest rates or changes in interest rates may have on either the broader financial markets or our affiliates' assets under management and associated fees.

With respect to our debt financings, we are exposed to potential fluctuations in the amount of interest expense resulting from changing interest rates. We seek to offset such exposure in part by entering into interest rate hedging contracts. See "Interest Rate Hedging Contracts".

Our annual interest expense increases or decreases by \$195,250 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 current bank debt.

### ◆ INTEREST RATE HEDGING CONTRACTS

We seek to offset our exposure under our debt financing arrangements to changing interest rates by entering into interest rate hedging contracts. As of December 31, 1998, we were 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 our borrowings and are linked to the three-month LIBOR. These 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 below 5%, our floating interest rate debt is swapped for fixed rate debt at rates ranging between 6.67% and 6.78%. We generally borrow at LIBOR and pay an additional interest margin as described above. The hedging contracts limit the effects of our payment of interest at equivalent LIBOR rates of 6.78% or less on up to \$185 million of indebtedness.

As of January 15, 1999, we have entered into a swap contract to cap potential interest rate increases on \$75 million of the \$185 million notional amount of swap contracts identified above at 5.99%.

There can be no assurance that we will continue to

maintain such hedging contracts at their existing levels of coverage or that the amount of coverage maintained will cover all of our indebtedness outstanding at any such time. In addition, as noted above, our existing hedging contracts subject us to the risk of payments of higher interest rates when prevailing LIBOR rates are less than 5%. Therefore, there can be no assurance that the hedging contracts will meet their overall objective of reducing our interest expense. In addition, there can be no assurance that we will be successful in obtaining hedging contracts in the future on our existing or any new indebtedness.

### ◆ RECENT ACCOUNTING DEVELOPMENTS

In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133"). FAS 133 standardizes the accounting for derivative instruments by requiring that all derivatives be recognized as assets and liabilities and measured at fair value. FAS 133 is effective for financial statements for fiscal years beginning after June 15, 1999.

We do not believe that the implementation of FAS 133 will have a material impact on our financial statements.

### ◆ ECONOMIC AND MARKET CONDITIONS

The financial markets and the investment management industry in general have experienced both record performance and record growth in recent years. For example, between January 1, 1995 and December 31, 1998, the S&P 500 Index appreciated at a compound annual rate of approximately 30.5% and the aggregate assets under management of mutual and pension funds grew at a compound annual rate of 20.7% during 1995-1997, according to the Federal Reserve Board and the Investment Company Institute. Domestic and foreign economic conditions and general trends in business and finance, among other factors, affect the financial markets and businesses operating in the securities industry. We cannot guarantee that broader market performance will be favorable in the future. Any decline in the financial

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

markets or a lack of sustained growth may result in a corresponding decline in our affiliates' performance and may cause our affiliates to experience declining assets under management and/or fees, which would reduce cash flow distributable to us.

### ♦ 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, we 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 we may invest in the future and, consequently, on our business, financial condition and results of operations.

### ♦ INFLATION

We do not believe that inflation or changing prices have had a material impact on our results of operations.

### ♦ QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We use interest-rate swaps to manage market exposures associated with our variable rate debt by creating offsetting market exposures. These instruments are not held for trading purposes. In the normal course of operations, we also face risks that are either nonfinancial or nonquantifiable. Such risks principally include country risk, credit risk, and legal risk, and are not represented

in the analysis that follows.

This analysis presents the hypothetical loss in earnings of the derivative instruments we held at December 31, 1998 that are sensitive to changes in interest rates. Interest rate swaps allow us to achieve a level of variable-rate and fixed-rate debt that is acceptable to us, and to reduce interest rate exposure. In each of our interest rate swaps, we have agreed with another party to exchange the difference between fixed-rate and floating rate interest amounts calculated by reference to an agreed notional principal amount. Under each of our interest rate swaps, interest rates on the notional amounts are capped at rates ranging between 6.67% and 6.78% upon quarterly reset dates. In addition, if LIBOR falls below 5% at a quarterly date, we are required to make a payment to our counterparty equal to the difference between the interest rate on our floating rate LIBOR debt on an annualized rate of between 6.67% and 6.78%, multiplied by the notional principal amount. At December 31, 1998, a total of \$185 million of our outstanding debt was subject to interest rate swaps (the "Original Swaps"), and our exposure was to changes in three-month LIBOR rates. Beginning in January 1999, we became a party to additional contracts with a \$75 million notional amount (the "Subsequent Swaps"). These contracts are designed to limit interest rate increases to 5.99% on this notional amount if three-month LIBOR rates fall below 5%.

The hypothetical loss in earnings on all derivative instruments that would have resulted from a hypothetical change of 10 percent in three-month LIBOR rates, sustained for three months, is estimated to be \$390,000. Because our net-earnings exposure under the combined debt and interest-rate swap was to three-month LIBOR rates, the hypothetical loss was calculated as follows: multiplying the notional amount of the swap by the effect of a 10% reduction in LIBOR under the Original Swaps, partially offset by the Subsequent Swaps and interest savings on the underlying debt.

## SELECTED HISTORICAL FINANCIAL DATA

Set forth below are selected financial data for the Company for the five 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.

(dollars in thousands, except as indicated and per share data)	1994	For the Years Ended December 31,			
	1995	1996	1997	1998	
<b>STATEMENT OF OPERATIONS DATA</b>					
Revenues	\$ 5,374	\$ 14,182	\$ 50,384	\$ 95,287	\$ 238,494
Operating expenses:					
Compensation and related expenses	3,591	6,018	21,113	41,619	87,669
Amortization of intangible assets	774	4,174	8,053	6,643	17,417
Depreciation and other amortization	19	133	932	1,915	2,707
Other operating expenses	1,000	2,567	13,115	22,549	37,921
Total operating expenses	5,384	12,892	43,213	72,726	145,714
Operating income (loss)	(10)	1,290	7,171	22,561	92,780
Non-operating (income) and expenses:					
Investment and other income	(966)	(265)	(337)	(1,174)	(2,251)
Interest expense	158	1,244	2,747	8,479	13,603
	(808)	979	2,410	7,305	11,352
Income before minority interest, income taxes and extraordinary item	798	311	4,761	15,256	81,428
Minority interest <sup>(1)</sup>	(305)	(2,541)	(5,969)	(12,249)	(38,843)
Income (loss) before income taxes and extraordinary item	493	(2,230)	(1,208)	3,007	42,585
Income taxes	699	706	181	1,364	17,034
Income (loss) before extraordinary item	(206)	(2,936)	(1,389)	1,643	25,551
Extraordinary item	—	—	(983)	(10,011)	—
Net income (loss)	\$ (206)	\$ (2,936)	\$ (2,372)	\$ (8,368)	\$ 25,551
Net income (loss) per share – basic	\$ (0.07)	\$ (2.95)	\$ (5.49)	\$ (3.69)	\$ 1.45
Net income (loss) per share – diluted	\$ (0.07)	\$ (2.95)	\$ (5.49)	\$ (1.02)	\$ 1.33
Average shares outstanding – basic	3,030,548	996,144	431,908	2,270,684	17,582,900
Average shares outstanding – diluted	3,030,548	996,144	431,908	8,235,529	19,222,831
<b>OTHER FINANCIAL DATA</b>					
Assets under management (at period end, in millions)	\$ 755	\$ 4,615	\$ 19,051	\$ 45,673	\$ 57,731
EBITDA (2)	1,444	3,321	10,524	20,044	76,312
EBITDA as adjusted (3)	587	1,371	7,596	10,201	45,675
Cash flow from operating activities	818	1,292	6,185	16,205	45,424
Cash flow used in investing activities	(6,156)	(37,781)	(29,210)	(327,275)	(72,665)
Cash flow from financing activities	9,509	46,414	15,650	327,112	28,163
<b>BALANCE SHEET DATA</b>					
Current assets	\$ 4,791	\$ 16,847	\$ 23,064	\$ 52,058	\$ 95,811
Acquired client relationships, net	3,482	18,192	30,663	142,875	169,065
Goodwill, net	5,417	26,293	40,809	249,698	321,409
Total assets	13,808	64,699	101,335	456,990	605,334
Current liabilities	2,021	4,111	23,591	18,815	64,617
Senior debt	—	18,400	33,400	159,500	190,500
Total liabilities	3,925	26,620	60,856	180,771	267,531
Minority interest <sup>(1)</sup>	80	1,212	3,490	16,479	24,148
Preferred stock	10,004	40,008	42,476	—	—
Stockholders' equity	9,803	36,867	36,989	259,740	313,655

(1) All but one of our affiliates are majority-owned subsidiaries (we own less than a 50% interest in Paradigm). Minority interest consists of that portion of each affiliate's operating results and net assets that are owned by minority owners and is reflected as a reduction of net income and stockholders' equity, respectively.

(2) EBITDA represents earnings before interest expense, income taxes, depreciation, amortization and extraordinary items. We believe EBITDA may be useful to investors as an indicator of our ability to service debt, to make new investments and to meet working capital requirements. EBITDA, as calculated by us, may not be consistent with computations of EBITDA by other companies. EBITDA 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.

(3) EBITDA as adjusted represents earnings after interest expense and income taxes but before depreciation and amortization and extraordinary items. We believe that this measure may be 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 Common Stock or pay dividends on Common Stock. EBITDA as adjusted, as calculated by us, may not be consistent with computations of EBITDA as adjusted by other companies. EBITDA as adjusted 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.



## REPORT OF INDEPENDENT ACCOUNTANTS

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Affiliated Managers Group, Inc. and Affiliates at December 31, 1997 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles. 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 of these statements in accordance with generally accepted auditing standards which required 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.



PricewaterhouseCoopers LLP

Boston, Massachusetts

March 22, 1999

# C O N S O L I D A T E D   B A L A N C E   S H E E T S

(in thousands)

December 31,  
1997                      1998

## A S S E T S

### Current assets:

Cash and cash equivalents	\$ 22,766	\$ 23,735
Investment advisory fees receivable	27,061	66,939
Other current assets	2,231	5,137

Total current assets	52,058	95,811
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Fixed assets, net	4,724	8,001
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Equity investment in Affiliate	1,237	1,340
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Acquired client relationships, net of accumulated amortization of \$6,142 in 1997 and \$13,870 in 1998	142,875	169,065
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Goodwill, net of accumulated amortization of \$13,502 in 1997 and \$23,191 in 1998	249,698	321,409
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Other assets	6,398	9,708
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Total assets	\$456,990	\$605,334
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## L I A B I L I T I E S   A N D   S T O C K H O L D E R S '   E Q U I T Y

### Current liabilities:

Accounts payable and accrued liabilities	\$ 18,815	\$ 42,617
Notes payable to related parties	–	22,000

Total current liabilities	18,815	64,617
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Senior bank debt	159,500	190,500
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Other long-term liabilities	1,656	11,614
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Subordinated debt	800	800
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Total liabilities	180,771	267,531
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Minority interest	16,479	24,148
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Commitments and contingencies	–	–
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### Stockholders' equity:

Preferred stock	–	–
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Convertible stock	–	30,992
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Common stock	177	177
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Additional paid-in capital	273,475	273,413
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Accumulated other comprehensive income	(30)	16
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Retained earnings (deficit)	(13,882)	11,669
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	259,740	316,267
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Less treasury shares	–	(2,612)
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Total stockholders' equity	259,740	313,655
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Total liabilities and stockholders' equity	\$456,990	\$605,334
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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,		
	1996	1997	1998
Revenues	\$ 50,384	\$ 95,287	\$ 238,494
Operating expenses:			
Compensation and related expenses	21,113	41,619	87,669
Amortization of intangible assets	8,053	6,643	17,417
Depreciation and other amortization	932	1,915	2,707
Selling, general and administrative	10,854	18,912	31,643
Other operating expenses	2,261	3,637	6,278
	43,213	72,726	145,714
Operating income	7,171	22,561	92,780
Non-operating (income) and expenses:			
Investment and other income	(337)	(1,174)	(2,251)
Interest expense	2,747	8,479	13,603
	2,410	7,305	11,352
Income before minority interest, income taxes and extraordinary item	4,761	15,256	81,428
Minority interest	(5,969)	(12,249)	(38,843)
Income (loss) before income taxes and extraordinary item	(1,208)	3,007	42,585
Income taxes	181	1,364	17,034
Income (loss) before extraordinary item	(1,389)	1,643	25,551
Extraordinary item, net	(983)	(10,011)	–
Net income (loss)	\$ (2,372)	\$ (8,368)	\$ 25,551
Income (loss) per share – basic:			
Income (loss) before extraordinary item	\$ (3.22)	\$ 0.72	\$ 1.45
Extraordinary item, net	(2.27)	(4.41)	–
Net income (loss)	\$ (5.49)	\$ (3.69)	\$ 1.45
Income (loss) per share – diluted:			
Income (loss) before extraordinary item	\$ (3.22)	\$ 0.20	\$ 1.33
Extraordinary item, net	(2.27)	(1.22)	–
Net income (loss)	\$ (5.49)	\$ (1.02)	\$ 1.33
Average shares outstanding – basic	431,908	2,270,684	17,582,900
Average shares outstanding – diluted	431,908	8,235,529	19,222,831

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

	For the Years Ended December 31,		
	1996	1997	1998
Net income (loss)	\$ (2,372)	\$ (8,368)	\$ 25,551
Foreign currency translation adjustment, net of taxes	22	(52)	46
Comprehensive income (loss)	\$ (2,350)	\$ (8,420)	\$ 25,597

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,

1996 1997 1998

Cash flow from operating activities:			
Net income (loss)	\$ (2,372)	\$ (8,368)	\$ 25,551
Adjustments to reconcile net income (loss) to net cash flow from operating activities:			
Amortization of intangible assets	8,053	6,643	17,417
Extraordinary item	983	10,011	–
Depreciation and other amortization	932	1,915	2,707
Deferred income tax provision (benefit)	(215)	1,012	10,410
Changes in assets and liabilities:			
Increase in investment advisory fees receivable	(8,473)	(3,980)	(38,053)
Increase in other current assets	(1,881)	(977)	(2,766)
Increase (decrease) in accounts payable, accrued expenses and other liabilities	6,849	(3,159)	22,489
Minority interest	2,309	13,108	7,669
Cash flow from operating activities	6,185	16,205	45,424
Cash flow used in investing activities:			
Purchase of fixed assets	(922)	(1,648)	(4,313)
Costs of investments, net of cash acquired	(25,646)	(325,896)	(66,102)
Sale of investment	642	–	–
Distributions received from Affiliate equity investment	275	229	675
Increase (decrease) in other assets	(3,639)	40	(1,225)
Loans to employees	–	–	(1,700)
Repayment on notes recorded in purchase of business	80	–	–
Cash flow used in investing activities	(29,210)	(327,275)	(72,665)
Cash flow from financing activities:			
Borrowings of senior bank debt	21,000	303,900	78,800
Repayments of senior bank debt	(6,000)	(177,800)	(47,800)
Repayments of notes payable	(1,212)	(5,878)	–
Borrowings of subordinated bank debt	–	58,800	–
Repayments of subordinated bank debt	–	(60,000)	–
Issuances of equity securities	2,485	217,021	(62)
Issuance of warrants	–	1,200	–
Repurchase of stock	(13)	–	(2,612)
Debt issuance costs	(610)	(10,131)	(163)
Cash flow from financing activities	15,650	327,112	28,163
Effect of foreign exchange rate changes on cash flow	46	(43)	47
Net increase (decrease) in cash and cash equivalents	(7,329)	15,999	969
Cash and cash equivalents at beginning of year	14,096	6,767	22,766
Cash and cash equivalents at end of year	\$ 6,767	\$ 22,766	\$ 23,735
Supplemental disclosure of cash flow information:			
Interest paid	\$ 2,905	\$ 8,559	\$ 11,780
Income taxes paid	436	256	3,358
Supplemental disclosure of non-cash investing activities:			
Decrease in liabilities related to acquisitions	–	(3,200)	–
Supplemental disclosure of non-cash financing activities:			
Stock issued in acquisitions	–	11,101	30,992
Common stock issued in exchange for Affiliate equity interests	–	1,849	–
Notes issued in acquisitions	6,686	–	22,000
Conversion of preferred stock to common stock	–	83,576	–

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

# CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(dollars in thousands)	Preferred Shares	Common Shares	Convertible Shares	Preferred Stock	Common Stock	Convertible Stock	Additional Paid-In Capital	Retained Earnings	Treasury Shares	Treasury Shares at Cost
December 31, 1995	109,851	825,000	—	\$ 40,008	\$ —	\$ —	\$ 1	\$ (3,142)	—	\$ —
Issuance of common stock	—	162,500	—	—	—	—	4	—	—	—
Issuance of preferred stock	3,703	—	—	2,481	—	—	—	—	—	—
Repurchase of preferred stock	(20)	—	—	(13)	—	—	—	—	—	—
Net loss	—	—	—	—	—	—	—	(2,372)	—	—
Other comprehensive income	—	—	—	—	—	—	—	22	—	—
December 31, 1996	113,534	987,500	—	42,476	—	—	5	(5,492)	—	—
Issuance of common stock	—	8,753,667	—	—	98	—	188,773	—	—	—
Issuance of preferred stock and warrants	45,715	—	—	41,100	—	—	1,200	—	—	—
Conversion of preferred stock	(159,249)	7,962,450	—	(83,576)	79	—	83,497	—	—	—
Net loss	—	—	—	—	—	—	—	(8,368)	—	—
Other comprehensive income	—	—	—	—	—	—	—	(52)	—	—
December 31, 1997	—	17,703,617	—	—	177	—	273,475	(13,912)	—	—
Issuance of common stock	—	—	—	—	—	—	(62)	—	—	—
Issuance of convertible stock	—	—	1,750,942	—	—	30,992	—	—	—	—
Purchase of common stock	—	—	—	—	—	—	—	—	(172,000)	(2,612)
Net income	—	—	—	—	—	—	—	25,551	—	—
Other comprehensive income	—	—	—	—	—	—	—	46	—	—
December 31, 1998	—	17,703,617	1,750,942	\$ —	\$177	\$ 30,992	\$ 273,413	\$ 11,685	(172,000)	\$(2,612)

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 organized either 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 capital and undistributed Owners’ Allocation 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. All dollar amounts in the text and tables herein are stated in thousands unless otherwise indicated. Certain reclassifications have been made to prior years’ financial statements to conform with the current year’s presentation.

#### SEGMENT REPORTING

In 1998, the Company adopted Statement of Financial Accounting Standards (FAS) 131, *Disclosures about Segments of an Enterprise and Related Information*. FAS 131 supersedes FAS 14, *Financial Reporting for Segments of a Business Enterprise*, replacing the “industry segment” approach with the “management” approach. The management approach designates the internal organization that is used by management for making operating decisions and assessing performance as the source of the Company’s reportable segments. FAS 131 also requires disclosures about products and services, geographic areas, and major customers. The adoption of FAS 131 did not affect results of operations or financial position (see Note 16).

#### 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 percentage 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.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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 28 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 is an impairment loss of \$4,628 relating to one of AMG'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 years ended December 31, 1997 or December 31, 1998.

### DEBT ISSUANCE COSTS

Debt issuance costs incurred in securing credit facility financing are capitalized and subsequently amortized over the term of the credit facility using the effective interest method. Unamortized debt issuance costs of \$10,011, net of tax were written off as an extraordinary item in 1997 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 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 basis 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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 10, the Company periodically purchases additional equity interests in Affiliates from minority interest owners. 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

FAS No. 123, "Accounting for Stock-Based Compensation", encourages but does not require adoption of a fair value-based accounting method for stock-based compensation arrangements which include 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.

### 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.

### RECENT ACCOUNTING DEVELOPMENTS

In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133"). FAS 133 standardizes the accounting for deriva-

tive instruments by requiring that all derivatives be recognized as assets and liabilities and measured at fair value. FAS 133 is effective for financial statements for fiscal years beginning after June 15, 1999.

The Company does not believe that the implementation of FAS 133 will have a material impact on the Company's financial statements.

## 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 cities in which 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, 1998, one of those Affiliates accounted for approximately 44% of AMG's share of the Owners' Allocation.

## 3. FIXED ASSETS AND LEASE COMMITMENTS

Fixed assets consist of the following:

	At December 31,	
	1997	1998
Office equipment	\$ 5,870	\$ 8,282
Furniture and fixtures	3,530	4,534
Leasehold improvements	2,007	3,473
Computer software	760	1,742
Total fixed assets	12,167	18,031
Accumulated depreciation	(7,443)	(10,030)
Fixed assets, net	\$ 4,724	\$ 8,001

The Company and its Affiliates lease computer equipment and office space for their operations. At December 31, 1998, the Company's aggregate future minimum payments for operating leases having initial or noncancelable lease terms greater than one year are payable as follows:

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ending December 31,	Required Minimum Payments
1999	\$5,349
2000	5,323
2001	4,438
2002	4,023
2003	2,662
Thereafter	8,592

Consolidated rent expense for 1996, 1997 and 1998 was \$2,359, \$3,637 and \$6,278, respectively.

### 4. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of the following:

	At December 31,	
	1997	1998
Accounts payable	\$ 940	\$ 928
Accrued compensation	6,480	25,201
Accrued income taxes	52	6,297
Accrued rent	2,769	2,413
Accrued interest	63	1,858
Deferred revenue	1,481	1,602
Accrued professional services	2,552	524
Other	4,478	3,794
	\$18,815	\$42,617

### 5. RETIREMENT PLANS

AMG has a defined contribution retirement plan covering substantially all of its full-time employees and four of its Affiliates. Seven of AMG's other Affiliates had 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 1996, 1997 and 1998 were \$656, \$1,020 and \$2,589, respectively.

### 6. SENIOR BANK DEBT AND SUBORDINATED DEBT

The Company has a \$300 million revolving Credit Facility ("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 \$190.5 million outstanding on the Credit Facility at December 31, 1998.

The effective interest rates on the outstanding borrowings were 5.7% and 7.2% at December 31, 1998 and 1997, respectively. All borrowings under the Credit Facility are collateralized by pledges of all capital stock or other equity interests in each AMG Affiliate owned and 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, 1998, the Company was 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 and are linked to the three-month LIBOR. 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 below 5%, the Company's floating interest rate debt is swapped for fixed rate debt at rates ranging between 6.67% and 6.78%. The Company generally borrows at LIBOR and pays an additional interest margin as described above. The hedging contracts limit the effects of the Company's payment of interests 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.

Beginning in January 1999, the Company became a party to a swap contract that limits interest rates on \$75 million of the \$185 million of swap contracts identified above at 5.99%. These contracts are designed to limit interest rate increases if floating rate debt is swapped for higher fixed rate debt under the terms of the original swap contracts.

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 thousand 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 members other than AMG.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 7. INCOME TAXES

A summary of the provision for income taxes is as follows:

	Year Ended December 31,		
	1996	1997	1998
Federal:			
Current	\$ -	\$ -	\$ -
Deferred	(233)	776	10,238
State:			
Current	397	352	6,624
Deferred	17	236	172
Provision for income taxes	\$ 181	\$1,364	\$17,034

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

	Year Ended December 31,		
	1996	1997	1998
Tax at U.S. federal income tax rate	(35)%	35%	35%
Nondeductible expenses, primarily amortization of intangibles	21	15	2
State income taxes, net of federal benefit	23	13	5
Valuation allowance	6	(17)	(2)
	15%	46%	40%

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

	December 31,	
	1997	1998
Deferred assets (liabilities):		
Net operating loss carryforwards	\$ 11,816	\$ 6,086
Intangible amortization	(10,337)	(17,455)
Accruals	849	2,363
Other, net	(339)	-
	1,989	(9,006)
Valuation allowance	(1,989)	(1,404)
Net deferred income taxes	\$ -	\$(10,410)

Deferred taxes reported at December 31, 1997 have been adjusted to reflect the filing of the Company's 1997 tax return.

At December 31, 1998, the Company had federal tax net operating loss carryforwards of approximately \$6 million which expire beginning in the year 2010 and other state net operating loss carryforwards which begin to expire in the year 2000. The realization of these carryforwards is dependent on generating sufficient taxable income prior to their expiration. The valuation allowance at December 31, 1998 is related to the uncertainty of the realization of the Company's state net operating loss carryforwards.

### 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

#### 1998

On March 20, 1998, the Company completed its investment in Essex. Essex is a Boston-based manager which specializes in investing in growth equities, using a fundamental research driven approach. AMG paid \$69.6 million in cash and 1,750,942 shares of its Series C Convertible Non-Voting Stock, for an indirect 68.0% interest in the Owner's Allocation (as defined in Note 1 above) of Essex. The Series C Stock is non-voting stock and carries no preferences with respect to dividends or liquidation. Each share of Series C Stock converted into one share of Common Stock on March 20, 1999.

On December 31, 1998, AMG acquired a 65% interest in Davis Hamilton Jackson. DHJA is a Houston based asset management firm with approximately \$3.5 billion of assets under management at December 31,



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1998. The Company issued notes to close the transaction which were settled on January 4, 1999. On January 6, 1999, the Company acquired an approximately 65% interest in Rorer. Rorer is a Philadelphia based investment advisor with approximately \$4.4 billion of assets under management at December 31, 1998. AMG paid approximately \$65 million in cash for its investment in Rorer. AMG financed these two investments with borrowings under its Credit Facility.

The results of operations of Essex and DHJA are included in the consolidated results of operations of the Company from their respective dates of acquisition, March 20, 1998 and December 31, 1998.

## 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 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 Burrridge. 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 Burrridge 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 Burrridge are included in the consolidated results of operations of the Company from their respective dates of acquisition, March 28, 1996 and December 31, 1996.

## PURCHASE PRICE OF INVESTMENTS

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,		
	1996	1997	1998
Allocation of			
Purchase Price:			
Net tangible assets	\$ 2,198	\$ 5,924	\$ 3,776
Intangible assets	35,040	331,421	115,318
Total purchase price	\$37,238	\$337,345	\$119,094

Unaudited pro forma data for the years ended December 31, 1997 and 1998 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 1997, assuming revenue sharing arrangements had been in effect for the entire period and after making certain other pro forma adjustments.

	Year Ended December 31,	
	1997	1998
Revenues	\$194,831	\$257,569
Income before extraordinary item	16,375	28,715
Extraordinary item	(10,011)	—
Net income	\$ 6,364	\$ 28,715
Income before extraordinary item per share – basic	\$ 0.85	\$ 1.64
Income before extraordinary item per share – diluted	0.84	1.47
Net income per share – basic	0.33	1.64
Net income per share – diluted	0.33	1.47

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

a five-year period, to make additional purchase payments of up to \$25 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.

### 10. 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 1998. 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, 1998 ranged from \$11.0 million on the one hand, assuming all such obligations occur due to early resignations or terminations for cause, and \$227.5 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 \$32.0 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.

### 11. STOCKHOLDERS' EQUITY

#### PREFERRED STOCK

The Company is authorized to issue up to 5,000,000 shares of Preferred Stock in classes or series and to fix the designations, powers, preferences and the relative, participating, optional or other special rights of the shares of each series and any qualifications, limitations and restrictions thereon as set forth in the Certificate. Any such Preferred Stock issued by the Company may rank prior to the Common Stock as to dividend rights, liquidation preference or both, may have full or limited voting rights and may be convertible into shares of Common Stock.

#### CONVERTIBLE STOCK

In March 1998, the Company issued 1,750,942 shares of Series C Convertible Stock in completing its investment in Essex Investment Management Company, LLC. This stock is a series of the Preferred Stock described above. Each share of Series C Stock converted into one share of Common Stock on March 20, 1999.

#### COMMON STOCK

The Company has 43,000,000 authorized shares of Common Stock (including Class B Common Stock) of which 17,703,617 and 17,531,617 shares were issued and outstanding at December 31, 1997 and 1998, respectively. On September 11, 1998, the Company's Board of Directors authorized a share repurchase program pursuant to which the Company could repurchase up to five percent of its outstanding shares of Common Stock. During 1998, the Company repurchased 147,000 shares

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

for \$2.6 million. The Company also repurchased 25,000 shares of Common Stock for \$5 thousand during 1998 pursuant to the terms of a Stock Purchase and Restriction Agreement.

On March 3, 1999, the Company completed a public offering of 5,529,954 shares of Common Stock, of which 4,000,000 shares were sold by the Company and 1,529,954 shares were sold by selling stockholders. AMG used the net proceeds from the offering to reduce indebtedness and will not receive any proceeds from the sale of Common Stock by the selling stockholders.

### 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"). Under the terms of the Stock Plans, the exercise price of incentive stock options granted must not be less than 100% of the fair market value of the Common Stock on the date of grant, as determined by the Board of Directors. At December 31, 1998, a total of 2,300,000 shares of Common Stock have been reserved for issuance under these plans, with a total of 312,500 shares of Restricted Stock sold and outstanding and 1,171,750 stock options granted and outstanding. 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 two to four years and are subject to significant forfeiture provisions and other restrictions.

The 1994 Incentive Stock Plan provides for the issuance of 125,000 shares of Common Stock. As of December 31, 1998, all 125,000 shares of Restricted Stock had been sold and all are now vested.

The 1995 Incentive Stock Plan (the "1995 Plan") provides for the issuance of 425,000 shares of Common Stock. As of December 31, 1998, the Company had sold an aggregate 212,500 shares of Restricted Stock under the 1995 Plan. At December 31, 1998, 146,875 of these shares were vested. In 1998, 25,000 of these shares of Restricted Stock were repurchased by the Company for

\$5 thousand. 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 under the 1995 Plan. These options vest over a three year period and expire ten years from the grant date. As of December 31, 1998, 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. In 1998, 57,500 of these options were forfeited and accordingly 532,500 are outstanding at December 31, 1998. On December 11, 1997, the Company granted an option to purchase 10,000 shares of Common Stock with an exercise price of \$24.9375 per share to a newly elected director of the Company. This option becomes exercisable in equal installments of 6.25% 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. The above options expire ten years after the grant date.

In 1998, the Company granted options to purchase 536,750 shares of Common Stock to officers and employees of the Company. The exercise price of 356,000 of these options is \$34.63. The exercise price of 5,250 of these options is \$14.25, and the exercise price of 175,500 of these options is \$27.69. All of these options expire ten years after the grant date.

The following table summarizes the transactions of the Company's stock option plans for the two year period ended December 31, 1998. No options were granted in the year ended December 31, 1996 or prior.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Number of Shares	Weighted Average Exercise Price
Unexercised options outstanding – December 31, 1996	–	\$ –
Options granted	692,500	21.60
Options exercised	–	–
Options forfeited	–	–
Unexercised options outstanding – December 31, 1997	692,500	21.60
Options granted	536,750	32.16
Options exercised	–	–
Options forfeited	(57,500)	23.50
Unexercised options outstanding – December 31, 1998	1,171,750	\$ 26.34
Exercisable options December 31, 1997	30,833	\$ 9.10
December 31, 1998	233,730	\$ 23.90

The following table summarizes information about the Company's stock options at December 31, 1998:

Range of Exercise Prices	Options Outstanding		Options Exercisable		
	Number Outstanding as of 12/31/98	Weighted Average Remaining Contractual Life (years)	Weighted Average Price	Number Exercisable as of 12/31/98	Weighted Average Price
\$ 9.10-14.25	97,750	8.5	\$ 9.38	62,980	\$ 9.21
23.50-27.69	718,000	9.2	24.54	81,750	23.50
34.63	356,000	9.3	34.63	89,000	34.63
\$ 9.10-34.63	1,171,750	9.1	\$ 26.34	233,730	\$ 23.90

### 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 consistent with the requirements of FAS 123, the Company's net income (loss) and net income (loss) per share would have been as follows:

	Year Ended December 31,		
	1996	1997	1998
Net income (loss) – as reported	\$ (2,372)	\$(8,368)	\$25,551
Net income (loss) – FAS 123 pro forma	(2,141)	(8,837)	24,408
Net income (loss) per share – basic – as reported	(5.49)	(3.69)	1.45
Net income (loss) per share – basic – FAS 123 pro forma	(4.96)	(3.89)	1.39
Net income (loss) per share – diluted – as reported	(5.49)	(1.02)	1.33
Net income (loss) per share – diluted – FAS 123 pro forma	(4.96)	(1.07)	1.27

The fair value of options granted in the year ended December 31, 1997 was estimated using the minimum value method prior to the initial public offering in November 1997 and the Black-Scholes option pricing model after the offering. The weighted average fair value of options granted in the year ended December 31, 1998 was estimated at \$14.24 per option using the Black-Scholes option pricing model. The following weighted average assumptions were used for the option valuations.

	Year Ended December 31,	
	1997	1998
Dividend yield	0%	0%
Volatility	26%	60%
Risk-free interest rates	5.96%	5.38%
Expected option lives in years	6.7	7

### 12. EARNINGS (LOSS) PER SHARE

The calculation for the basic earnings per share is based on the weighted average of common shares outstanding



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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. The following is a reconciliation of the numerators and denominators of the basic and diluted EPS computations.

	1996	1997	1998
Numerator:			
Income (loss)			
before extra-			
ordinary item	\$ (1,389,000)	\$ 1,643,000	\$ 25,551,000
Denominator:			
Average shares			
outstanding –			
basic	431,908	2,270,684	17,582,900
Convertible			
preferred stock	–	5,496,330	1,376,768
Stock options			
and unvested			
restricted stock	–	468,515	263,163
Average shares			
outstanding –			
diluted	431,908	8,235,529	19,222,831
Income (loss) before			
extraordinary item			
per share:			
Basic	\$(3.22)	\$ 0.72	\$1.45
Diluted	\$(3.22)	\$ 0.20	\$1.33

### 13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company is exposed to market risks brought on by changes in interest rates. Derivative financial instruments are used by the Company to reduce those risks, as explained in this note.

#### (A) NOTIONAL AMOUNTS AND CREDIT EXPOSURES OF DERIVATIVES

The notional amount of derivatives do not represent amounts that are exchanged by the parties, and thus are not a measure of the Company's exposure. The amounts exchanged are calculated on the basis of the notional or contract amounts, as well as on other terms of the interest rate swap derivatives, and the volatility of these rates and prices.

The Company would be exposed to credit-related losses in the event of nonperformance by the counter-parties that issued the financial instruments. The Com-

pany does not expect that the counter-parties to interest rate swaps will fail to meet their obligations, given their high credit ratings. The credit exposure of derivative contracts is represented by the positive fair value of contracts at the reporting date, reduced by the effects of master netting agreements. The Company generally does not give or receive collateral on interest rate swaps due to its own credit rating and that of its counter-parties.

#### (B) INTEREST RATE RISK MANAGEMENT

The Company enters into interest rate swaps to reduce exposure to interest-rate risk connected to existing liabilities. The Company does not hold or issue derivative financial instruments for trading purposes. Interest rate swaps allow the Company to achieve a level of variable-rate and fixed-rate debt that is acceptable to management, and to cap interest rate exposure. The Company agrees with another party to exchange the difference between fixed-rate and floating rate interest amounts calculated by reference to an agreed notional principal amount.

#### (C) FAIR VALUE

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following tables present a comparison of the carrying value and estimated fair value of the Company's financial instruments at December 31, 1997 and 1998:

	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)

	December 31, 1998	
	Carrying Value	Estimated Fair Value
Financial assets:		
Cash and cash equivalents	\$ 23,735	\$ 23,735
Notes receivable	1,700	1,700
Financial liabilities:		
Notes payable	(22,000)	(22,000)
Senior bank debt	(190,500)	(190,500)
Off-balance sheet financial instruments:		
Interest-rate hedging agreements	–	(7,446)

The carrying amount of cash and cash equivalents approximates fair value because of the short term nature of these instruments. The carrying value of notes receivable approximate fair value because interest rates and other terms are at market rates. The carrying value of notes payable approximates fair value principally because of the short term nature of the note. 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 rates. The fair values of interest rate hedging agreements are quoted market prices based on the estimated amount necessary to terminate the agreements.

#### 14. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following is a summary of the unaudited quarterly results of operations of the Company for 1997 and 1998.

	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	
1998		First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenues	\$ 45,723	\$ 56,586	\$ 55,892	\$ 80,293	
Operating income	16,693	22,233	21,349	32,505	
Income before income taxes	7,437	9,858	9,773	15,517	
Net income	\$ 4,462	\$ 5,915	\$ 5,864	\$ 9,310	
Net income per share – basic	\$ 0.25	\$ 0.34	\$ 0.33	\$ 0.53	
Net income per share – diluted	\$ 0.25	\$ 0.30	\$ 0.30	\$ 0.48	

During the fourth quarter of 1998, the Company experienced increases in revenues, operating income, income before income taxes and extraordinary item, and income before extraordinary item from the same period in 1997 substantially as a result of new Affiliate investments.

#### 15. RELATED PARTY TRANSACTIONS

During 1998, the Company initiated an employee loan program. Loans to employees accrue interest at the Company's borrowing rate and have a stated 30-year maturity date. Outstanding balances are payable in full when employees terminate employment with the Company. At December 31, 1998 loans outstanding totaled \$1.7 million.

#### 16. SEGMENT INFORMATION

The Company and its affiliates provide investment advisory services to mutual funds and individual and institutional accounts. The Company's revenues are generated substantially from providing these investment advisory services to domestic customers.

The Affiliates are all managed by separate Affiliate management teams in accordance with the respective agreements between the Company and each Affiliate. While

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

the Company has determined that each of its Affiliates represents a separate reportable operating segment, because the Affiliates offer comparable investment products and services, have similar customers and distribution channels, and operate in a similar regulatory environment, the Affiliates have been aggregated into one reportable segment for financial statement disclosure purposes.

### 17. EVENTS SUBSEQUENT TO DECEMBER 31, 1998

On January 6, 1999, the Company completed its investment in Rorer. The total purchase price associated with this investment is allocated as follows:

Net tangible assets	\$ 744
Intangible assets	64,621
Total purchase price	\$ 65,365

The amortization periods used for intangible assets for this investment are 24 years for acquired client relationships and 30 years for goodwill. Unaudited pro forma data for the years ended December 31, 1997 and 1998 are set forth below, giving consideration to investments occurring in the two years ended December 31, 1998, as well as the investment in Rorer, as if such transactions had occurred as of the beginning of 1997, assuming revenue sharing arrangements had been in effect for the entire period and after making certain other pro forma adjustments.

### COMMON STOCK INFORMATION

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

Our 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 our initial public offering on November 21, 1997.

	High	Low
1998		
First Quarter	\$37 <sup>3</sup> / <sub>16</sub>	\$27 <sup>1</sup> / <sub>4</sub>
Second Quarter	39 <sup>3</sup> / <sub>16</sub>	34 <sup>1</sup> / <sub>16</sub>
Third Quarter	37 <sup>7</sup> / <sub>16</sub>	13 <sup>11</sup> / <sub>16</sub>
Fourth Quarter	30 <sup>3</sup> / <sub>4</sub>	13 <sup>11</sup> / <sub>16</sub>
1997		
Fourth Quarter (since November 21, 1997)	29 <sup>7</sup> / <sub>8</sub>	24

	Year Ended December 31,	
	1997	1998
Revenues	\$208,940	\$278,327
Income before extraordinary item	15,579	28,338
Extraordinary item	(10,011)	—
Net income	5,568	28,338
Income before extraordinary item per share – basic	\$ 0.81	\$ 1.61
Income before extraordinary item per share – diluted	0.80	1.45
Net income per share – basic	0.29	1.61
Net income per share – diluted	0.29	1.45

On January 29, 1999 the Company expanded the Credit Facility to \$330 million, adding another major commercial bank to its group of lenders. The Company has the option, with the consent of its lenders, to increase the facility by another \$70 million to a total of \$400 million.

On January 29, 1999, the Company entered into a definitive agreement to acquire substantially all of the partnership interests in The Managers Funds, L.P., which serves as the adviser to a family of ten equity and fixed income no-load mutual funds. The Managers Funds, L.P. managed a total of \$1.8 billion in these funds at December 31, 1998. This transaction is subject to customary closing conditions.

The closing price for the shares on the New York Stock Exchange on March 26, 1999 was \$24 <sup>5</sup>/<sub>8</sub>.

As of December 31, 1998 there were 95 stockholders of record. As of March 26, there were 119 stockholders of record.

We have not declared a dividend with respect to the periods presented. We intend to retain earnings to repay debt and to finance the growth and development of our business and do not anticipate paying cash dividends on our Common Stock in the foreseeable future. Our credit facility also prohibits us from making dividend payments to our 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

PricewaterhouseCoopers LLP  
Boston, Massachusetts

### TRANSFER AGENT AND REGISTRAR

ChaseMellon Shareholder Services L.L.C.  
New York, New York

### STOCK EXCHANGE LISTING

New York Stock Exchange  
Ticker Symbol: AMG

### ANNUAL MEETING

The Annual Meeting of Shareholders will be held at the offices of Goodwin, Procter & Hoar LLP, Exchange Place, Boston, Massachusetts, on May 25, 1999.

### 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  
*Chairman, CEO and President*  
Richard E. Floor  
*Partner, Goodwin, Procter & Hoar LLP*  
P. Andrews McLane  
*Senior Managing Director, TA Associates, Inc.*  
John M.B. O'Connor  
*General Partner, Chase Capital Partners*  
W.W. Walker, Jr.  
*Senior Managing Director, NationsBank Capital Investors*  
William F. Weld  
*Partner, McDermott, Will & Emery*

### EXECUTIVE OFFICERS

William J. Nutt  
*Chairman, CEO and President*  
Sean M. Healey  
*Executive Vice President*  
Lee Chertavian  
*Senior Vice President, Affiliate Support*  
Darrell W. Crate  
*Senior Vice President and Chief Financial Officer*  
Nathaniel Dalton  
*Senior Vice President, General Counsel and Secretary*  
Seth W. Brennan  
*Vice President*  
John Kingston, III  
*Vice President and Associate General Counsel*  
Jeffrey S. Murphy  
*Vice President*  
Daniel J. Shea  
*Vice President*





AFFILIATED MANAGERS GROUP, INC.

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Two International Place ♦ Boston, Massachusetts 02110  
617-747-3300 ♦ Fax 617-747-3380 ♦ [www.amg-boston.com](http://www.amg-boston.com)