

**Affiliated Managers Group**

Annual Report 2004



## Affiliated Managers Group, Inc. (NYSE: AMG)

is an asset management company which operates through a diverse group of high-quality mid-sized asset management firms (its “Affiliates”). AMG’s unique partnership approach with its Affiliates preserves the entrepreneurial orientation that distinguishes the most successful investment management firms. AMG promotes the continued growth and strong performance of its Affiliates by:

- **Maintaining and enhancing Affiliate managers’ equity incentives in their firms;**
- **Preserving each Affiliate’s distinct culture and investment focus; and**
- **Leveraging AMG’s scale to expand the product offerings and distribution capabilities of its Affiliates, and to provide its Affiliates access to the highest quality operations, compliance and technology resources.**

AMG seeks to achieve earnings growth through the internal growth of its Affiliates, growth and development initiatives designed to enhance its Affiliates’ businesses, and investments in new Affiliates. AMG’s Affiliates collectively manage approximately \$133 billion in more than 175 investment products across the mutual fund, institutional and high net worth distribution channels. AMG has achieved strong long-term growth in earnings, with compound annual growth in Cash earnings per share of over 20 percent since its initial public offering in 1997.

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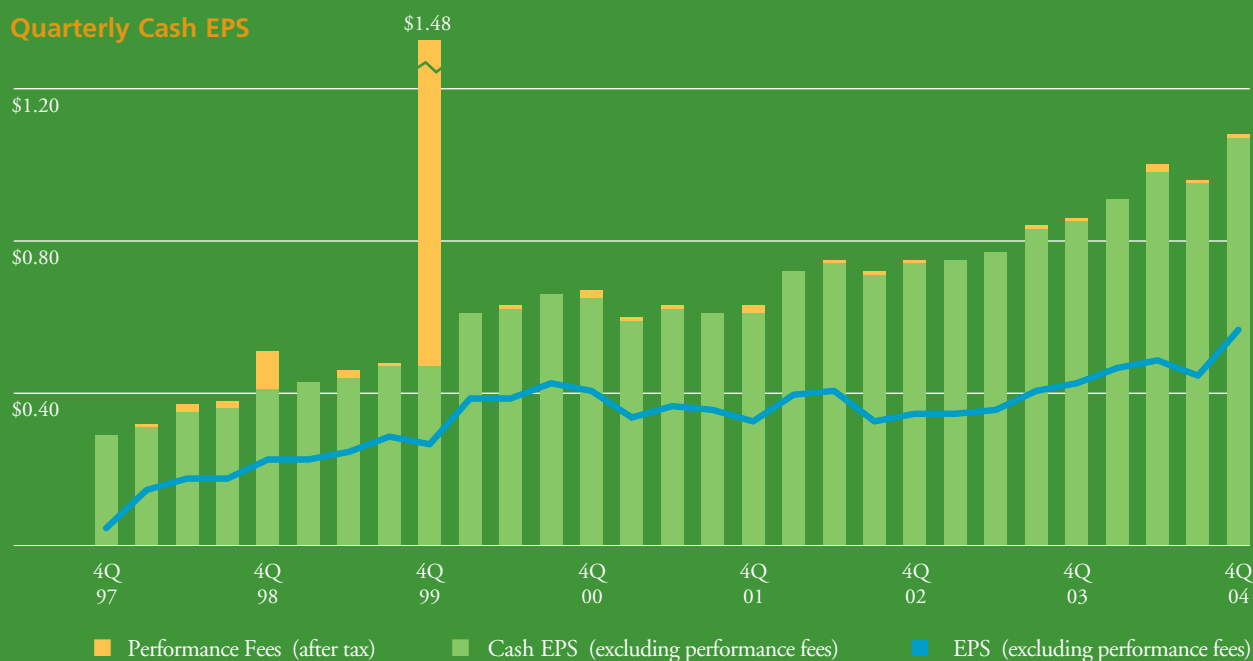
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## Financial Highlights

	Years ended December 31,			
(in millions, except as indicated and per share data)	2002	2003	2004	AMG 1
Operating Results				
Revenue	\$ 482.5	\$ 495.0	\$ 660.0	
Net Income	55.9	60.5	77.1	
Cash Net Income <sup>(1)</sup>	99.5	104.9	126.5	
EBITDA <sup>(2)</sup>	138.8	147.2	186.4	
Earnings per share – diluted <sup>(3)</sup>	\$ 1.52	\$ 1.57	\$ 2.02	
Cash earnings per share – diluted <sup>(4)</sup>	2.94	3.21	3.95	
Balance Sheet Data				
Total assets	\$ 1,243.0	\$ 1,519.2	\$ 1,933.4	
Senior indebtedness	229.0	423.3	550.7	
Mandatory convertible securities	230.0	230.0	300.0	
Stockholders' equity	571.9	614.8	707.7	
Other Financial Data				
Assets under management (at period end, in billions)	\$ 70.8	\$ 91.5	\$ 129.8	
Average shares outstanding – diluted <sup>(3)</sup>	38.2	40.1	39.6	
Average shares outstanding – adjusted diluted <sup>(5)</sup>	33.9	32.7	32.0	

\* For the Financial Highlights notes referenced above, please see page 82.

### Quarterly Cash EPS





**AMG had an outstanding year in 2004**, as we made significant strides in executing our strategy to generate value for our shareholders. Our Affiliates achieved strong internal growth through solid investment performance and positive net client cash flows. We successfully implemented initiatives to provide industry-leading operating and distribution capabilities to enhance our Affiliates' businesses. Finally, we also grew by adding new, high-quality Affiliates, making accretive investments in three outstanding firms – each of which is a demonstrated leader in its area of the market.

Since our founding, AMG has adhered to a strategy of investing in top-performing mid-sized asset managers that participate in the most attractive areas in the investment management industry. AMG's partnership approach with our Affiliates preserves and enhances the incentives for continued growth through retained direct equity ownership, while maintaining the distinctive culture and entrepreneurial focus that gives performance-oriented mid-sized firms their competitive advantage.

With AMG's increasing scale and experience, and the diverse opportunities provided by the more than 175 investment products managed by our Affiliates, AMG is poised to capitalize on our favorable position to add meaningfully to our growth – through the internal growth of our Affiliates, and by making additional investments in new Affiliates.

**The success of our strategy has created solid financial results.** Cash earnings per share for 2004 increased 23 percent, to \$3.95, continuing AMG's record of strong compounded annual growth in cash earnings of 22 percent since our initial public offering in 1997. EBITDA increased by approximately 27 percent from 2003 to \$186 million in 2004.

**AMG's Affiliates produced strong growth through superior investment performance and positive net client cash flows.** Our Affiliates are among the leading firms in their chosen disciplines, and against the backdrop of relatively mixed equity markets during 2004, demonstrated that active portfolio management and mid-sized entrepreneurial firms can generate superior results. Net client cash flows continued to be positive overall during 2004 – excluding negative flows at one Affiliate, AMG's Affiliates added approximately \$7.5 million to our annualized EBITDA through over \$3.9 billion in positive net client cash flows. This continues our Affiliates' record of strong growth from net inflows, as they have generated positive EBITDA growth from net client cash flows in each of the last five years across a range of equity market conditions.

Among our larger and higher-margin Affiliates, Tweedy, Browne Company, Friess Associates, Third Avenue Management, and First Quadrant had particularly noteworthy years in 2004.

CASH EARNINGS PER SHARE FOR 2004 INCREASED 23 PERCENT,  
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INITIAL PUBLIC OFFERING IN 1997. EBITDA INCREASED BY APPROX-  
IMATELY 27 PERCENT FROM 2003 TO \$186 MILLION IN 2004.

Bottom photo  
from left to right:

AMG

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**Seth W. Brennan**

Executive Vice President,  
New Investments

**Sean M. Healey**

President and  
Chief Executive Officer

**Darrell W. Crate**

Executive Vice President  
and Chief Financial Officer

**William J. Nutt**

Chairman

**Nathaniel Dalton**

Executive Vice President,  
Affiliate Development

**John Kingston, III**

Senior Vice President and  
General Counsel



Tweedy, Browne had an excellent year with strong mutual fund and institutional net client cash flows, as well as superior investment returns. Tweedy, Browne's highly-regarded Global Value Fund outperformed the hedged MSCI EAFE index by more than eight percent in 2004, continuing its long-term outperformance record of approximately 12 percent compounded over the index for the last five years.

Friess Associates, a growth equity manager with an intensive, bottom-up approach to investing, is principally known for its mutual fund products, but last year also generated significant growth by expanding its institutional and high net worth businesses, attracting nearly \$1 billion in net client inflows in these channels. Their Brandywine family of mutual funds continues to have excellent investment performance, with the Brandywine, Brandywine Blue and Brandywine Advisors funds all rated four- or five-stars by Morningstar.

Third Avenue's highly-rated Third Avenue Value, Third Avenue Small-Cap Value, Third Avenue International Value and Third Avenue Real Estate Value funds each had an exceptional year and outperformed their peers. Through a combination of substantial net client cash flows and superior investment performance, Third Avenue has nearly tripled in size since our investment in 2002.

First Quadrant, a leading quantitative manager with approximately \$21 billion in assets under management, grew substantially in 2004 as well, coupling an outstanding year in investment performance with almost \$2 billion in net client inflows.

**We enhanced our Affiliates' growth and operations by applying our expertise, scale, and resources in areas such as distribution and compliance.** In 2004, we formed Managers Investment Group to capitalize on AMG's breadth of products and resources by creating an industry-leading platform to distribute our Affiliates' products into retail distribution channels. Managers Investment Group has already developed a substantial marketing platform, with more than 30 seasoned sales professionals dedicated to distributing separate account and mutual fund products through brokerage firms, banks, insurance companies and defined contribution and other platforms. Over 75 of AMG's Affiliates' products are already being distributed by Managers Investment Group, and we see the ability to generate significant additional growth as more Affiliate products are sold through this channel.

We also significantly expanded our centralized legal and compliance resources at AMG, offering comprehensive, leading-edge compliance capabilities to our Affiliates as the regulatory climate in the investment management industry continues to increase in complexity. This initiative brings the knowledge and experience of AMG's senior attorneys and compliance professionals to our Affiliates, providing industry expertise at a level well beyond that which would be typically available to mid-sized firms.



Managers Investment Group and AMG's centralized legal and compliance resources are examples of the significant benefits of scale we can bring to our Affiliates (without disrupting the advantages mid-sized firms have in maintaining a strict adherence to an investment discipline and in preserving a service-oriented, entrepreneurial culture). Our approach is designed to meaningfully strengthen and help grow our Affiliates' businesses, using AMG's substantial resources and experience while carefully cultivating the incentives and distinct identity of each of our Affiliates that have led to their continued success.

**In 2004, we welcomed three outstanding new Affiliates.** AMG also had an excellent year in our new investments area, as we completed investments in Genesis Fund Managers, AQR Capital Management and TimesSquare Capital Management. In addition to being excellent investment management firms, these new Affiliates add materially to the growth potential of AMG through their participation in some of the fastest growing areas of the investment business. With a number of alternative, international, and other high-quality equity products, these three outstanding firms further enhance the diversity of our product offerings.

Genesis, with approximately \$11 billion in assets under management, is AMG's first internationally-based Affiliate, and also our first Affiliate concentrating in emerging markets equity securities.

AQR, with nearly \$13 billion in assets under management, is our first Affiliate specializing in alternative investment products, and significantly expands our participation in investment strategies designed to have a low correlation to the traditional markets.

TimesSquare, with approximately \$5.5 billion in assets under management, is a leading growth equity manager that provides AMG with additional products in the small-, small/mid-, and mid-cap growth areas.

We also continued to build on the scale of our existing businesses by acquiring additional firms and products on their behalf in 2004, through the consolidation of the mutual fund assets of Fremont Investment Advisors and Conseco Capital Management into The Managers Funds mutual fund family.

With a favorable climate for asset management transactions and AMG's strong position as a preferred partner for leading mid-sized firms, we are confident that we will continue to add materially to AMG's growth and diversity through investments in attractive new Affiliates.

**We have the management depth, financial strength and flexibility to continue to execute our growth strategy.** We have continued to broaden and expand our management team as our business has grown and evolved. Our core group of senior executives has been with AMG

since the Company's earliest days, and we also have added other experienced professionals to further strengthen and add depth to our management. Finally, our Board of Directors named Sean Healey President and Chief Executive Officer of AMG at the end of 2004. Sean had been serving as AMG's President and Chief Operating Officer and has had a leading role in building our business since joining AMG in 1995.

Our financial strength and significant recurring free cash flow provide the foundation for our growth initiatives, as well as the flexibility to efficiently manage our capital and meet our financial commitments. With a strong balance sheet and minimal requirements for capital expenditures, we have the capacity to execute our growth strategy of making investments in new Affiliates, investing in our existing businesses, and repurchasing our stock when appropriate.

**We are very optimistic** about AMG's prospects looking forward. Our Affiliates are well-positioned in the most dynamic areas of the investment management industry, and highly incented to continue to develop their businesses for the long-term. We have exciting initiatives in place and the resources to meaningfully support their growth and operations. We also continue to see substantial opportunities for material growth through investments in new Affiliates. Finally, we have the experience and the financial strength and flexibility to capitalize on our strong position to generate growth and shareholder value.

In closing, we would like to take this opportunity to express our appreciation to Stephen J. Lockwood, who is stepping down from our Board of Directors in June, for his outstanding service to AMG. We are grateful for Steve's contributions to AMG throughout his tenure, and his dedication and guidance will be missed. We also would like to express our appreciation to those responsible for our continued success: the management and employees of our Affiliates; the employees of AMG and our service providers; our Board of Directors; and our shareholders for their ongoing support.



**William J. Nutt**

*Chairman*



**Sean M. Healey**

*President and CEO*





## AMG follows a proven, disciplined strategy for building its business:

invest in excellent mid-sized investment management businesses; allow management to retain equity in their firm as a powerful incentive for growth through a partnership structure that preserves the unique culture and approach that has led to their success; and then provide these Affiliates with a range of growth and development initiatives designed to enhance their businesses.

AMG's success over the past ten years has created a strong foundation for continued growth. With the diversity and strong performance of AMG's Affiliates, a proven ability and capacity to execute its growth initiatives, and AMG's established position as a leading succession planning partner for growing mid-sized asset management firms, AMG is well-positioned to continue to successfully execute its growth strategy and generate shareholder value in the future.



## INVESTMENT PRODUCTS

AMG has an extraordinarily broad and diverse selection of investment products, with its Affiliates managing more than 175 products with strong positioning and outstanding performance in each major product category: global, international, and emerging markets equities; domestic equities; alternative products; and fixed income and balanced products. AMG's Affiliates predominantly offer active portfolio management of domestic and international equities, which, combined with a growing emphasis on alternative investments and other quantitative strategies, gives AMG a significant presence in the most dynamic and fastest growing areas of the investment management industry. AMG's Affiliates are among the leading investors in their disciplines, with years of successful application of their investment processes demonstrated in their outstanding long-term performance records.

During the past year, AMG added to its product diversity, focusing on high-growth areas of the industry and further increasing the balance in AMG's sources of earnings. At year end, 53 percent of AMG's EBITDA was derived from domestic equity products (including both growth and value styles) and 26 percent from international equity products. While earnings from equity products comprised 79 percent of AMG's EBITDA, alternative investments increased to 14 percent



AMG'S AFFILIATES ARE AMONG THE LEADING INVESTORS IN

THEIR DISCIPLINES, WITH YEARS OF SUCCESSFUL APPLICATION OF

THEIR INVESTMENT PROCESSES DEMONSTRATED IN THEIR

OUTSTANDING LONG-TERM PERFORMANCE RECORDS.



AMG'S STRONG AND DIVERSE ARRAY OF PRODUCTS ENABLES IT

TO PARTICIPATE IN THE MOST ATTRACTIVE SEGMENTS OF THE

INVESTMENT MANAGEMENT INDUSTRY, WHILE GENERATING

INCREMENTAL GROWTH BY INTRODUCING AFFILIATE

PRODUCTS INTO ADDITIONAL DISTRIBUTION CHANNELS.

of total EBITDA at the end of 2004. AMG's strong and diverse array of products enables it to participate in the most attractive segments of the investment management industry, while generating incremental growth by introducing Affiliate products into additional distribution channels.



### Global, International and Emerging Markets Equities

AMG's Affiliates are among the leading mid-sized firms investing in international securities on behalf of their clients, managing global, international and emerging markets equities through products with distinct quantitative, value, or growth styles. AMG's Affiliates, particularly Tweedy, Browne Company, Third Avenue Management, Genesis Fund Managers, and AQR Capital Management, are well-known for their experience investing in international markets and provide AMG with approximately 26 percent of its EBITDA from participation in these products.

Tweedy, Browne's Global Value Fund is among the largest and most distinguished global value equity products, and follows a diversified, Graham and Dodd value approach to global investing. The fund, which holds a diverse portfolio of undervalued small- and mid-cap stocks, has an excellent long-term track record of stock selection and performance. Unlike many global managers, Tweedy, Browne hedges its currency exposure, and, by selecting undervalued companies, the fund outperformed the hedged MSCI EAFE index by approximately 800 basis points in 2004 and over 650 basis points on an annualized basis over the past 10 years.

Third Avenue's International Value Fund also applies a disciplined value philosophy to investing in international equities, utilizing the firm's "safe and cheap" investment approach with outstanding recent and longer-term results. The portfolio outperformed the MSCI EAFE index by more than 700 basis points and 1200 basis points for the prior one- and three-year periods, respectively.

AMG's newest Affiliate, AQR, applies its quantitative value and momentum approach through its Enhanced Value International Equity products to develop diversified portfolios that are overweight on cheap (and, in turn, underweight on expensive) international securities, countries and currencies to achieve long-term success in both investment performance and risk management. AQR's longest running Enhanced Value International Equity product has

**EBITDA  
By Asset Class**



26%  
**International  
Equity**

14%  
**Alternative**

32%  
**U.S. Growth  
Equity**

21%  
**U.S. Value  
Equity**

7%  
**Fixed Income,  
Balanced,  
Other**



### EBITDA By Asset Class



26%  
International  
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7%  
Fixed Income,  
Balanced,  
Other

generated strong long-term returns, outperforming the MSCI EAFE Free index by approximately 300 basis points on an annualized basis since its inception in 2000.

The Genesis Emerging Markets Fund has had one of the most distinguished records in emerging markets equity investing since its inception in 1989. Genesis has successfully executed its investment discipline to identify attractive investments in global emerging markets with outstanding results, outperforming its benchmark MSCI EM Free index by approximately 700 basis points in 2004 and over 550 basis points and 600 basis points on an annualized basis over the past three- and five-year periods, respectively.



### Alternative Products

AMG entered 2004 well-positioned with strong participation in quantitative and alternative products through leading firms such as First Quadrant and Third Avenue, and AMG further increased its presence in these products through its investment in AQR, one of the industry's leading hedge fund managers. Following the AQR investment, alternative products provided AMG with approximately 14 percent of its EBITDA at the end of 2004. Among the most rapidly-growing segments of the asset management industry, alternative products also offer the ability to generate strong returns with low correlation to traditional asset classes and the potential to earn incremental fees based upon the performance of these products.

AQR employs strategies ranging from aggressive high-volatility, market-neutral hedge funds to low-volatility, benchmark-driven traditional products. AQR's flagship Absolute Return Fund invests in up to 17 distinct long-short, arbitrage and other quantitative strategies utilizing their consistent underlying investment philosophy to seek attractive returns with low correlation to one another or to the broader markets, and has achieved an excellent investment record, outperforming the CSFB/Tremont Hedge Fund index by approximately 400 basis points and 1100 basis points annually over the past three- and five-year periods, respectively. In addition, AQR also offers a selection of global asset allocation and global stock selection products as well as single-strategy products.

First Quadrant's Global Tactical Asset Allocation (GTAA) product seeks to add value and stabilize long-term total returns by actively overweighting undervalued global equity and bond





## DISTRIBUTION CHANNELS

### MUTUAL FUND

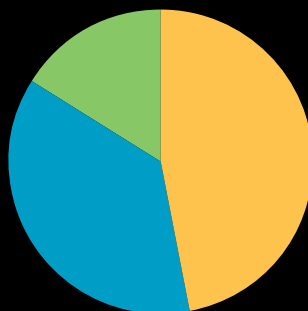
47%

### INSTITUTIONAL

37%

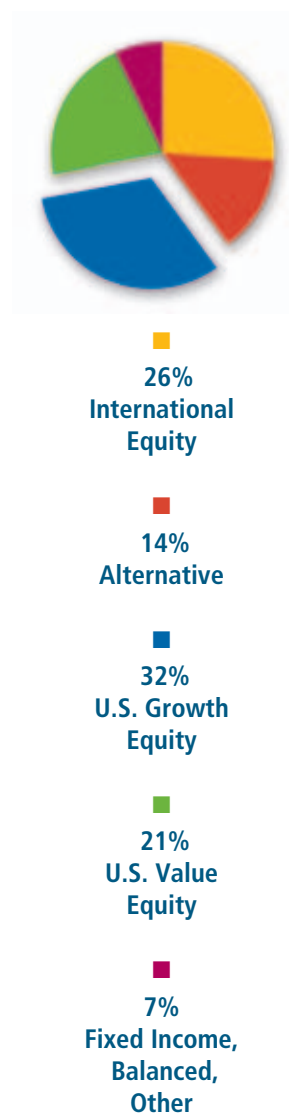
### HIGH NET WORTH

16%



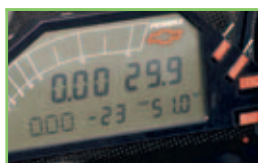
EBITDA by distribution channel

### EBITDA By Asset Class



markets while concurrently underweighting markets that are overvalued. The firm's GTAA long/short strategy outperformed its blended custom benchmark by over 300 basis points and approximately 150 basis points on an annualized basis over the past three- and five-year periods, respectively, with significantly lower risk. Its U.S. Market Neutral strategy, which applies a long-short, fundamentally-based quantitative process that combines bottom-up stock selection with top-down style and industry rotation, generated annualized returns above its benchmark of approximately 140 basis points, 210 basis points, and 40 basis points over the past one-, three- and five-year periods, respectively. In addition to its GTAA and U.S. Market Neutral products, First Quadrant also offers a number of other products targeted to investors seeking absolute returns or a complement to other strategies, including its Tactical Currency Allocation product and its European Market Neutral product.

Third Avenue applies its disciplined value approach to products investing in real estate securities, as well as in distressed securities and other special situations. The Third Avenue Real Estate Value Fund invests primarily in equity and debt securities of companies in the real estate industry or related industries, using bottom-up, fundamental analysis to identify undervalued securities. The fund is rated five-stars by Morningstar, and has produced average annual returns of over 20 percent for each of the past one-, three- and five-year periods. Third Avenue also has a long history of including investments in distressed debt securities within its equity mutual funds, and has extended this expertise to investing in distressed and other special situations through private investment partnerships.



### U.S. Growth Equity

AMG's Affiliates are among the leading mid-sized managers in the active management of U.S. equities, particularly in specialized areas such as small- and mid-cap stocks. In providing growth equity expertise, Friess Associates, Essex Investment Management, Frontier Capital Management, and Davis Hamilton Jackson each has a strong market position and is well-respected as a leading growth investor. AMG added significant expertise and capacity in this segment with its investment in 2004 in one of the largest and best-known small-cap growth managers in the industry, TimesSquare Capital Management. At year end, growth equity products provided approximately 32 percent of AMG's EBITDA.



## MUTUAL FUND DISTRIBUTION CHANNEL

AMG has a strong presence in the mutual fund channel, with Affiliates providing advisory or sub-advisory services to more than 50 mutual funds. These funds are distributed to retail and institutional clients directly and through intermediaries, including independent investment advisors, retirement plan sponsors, broker-dealers, major fund marketplaces and bank trust departments.

Utilizing the distribution, sales and client service capabilities of Managers Investment Group, AMG offers its Affiliates access to the mutual fund distribution channel. For an Affiliate with a predominantly institutional or high net worth clientele, a presence in the mutual fund channel can be established by leveraging Managers' operational infrastructure and marketing capabilities. Managers also offers those Affiliates with an existing presence in the mutual fund channel the opportunity to expand their distribution, operating as a single point of contact for retail intermediaries such as banks, brokerage firms and other sponsored platforms.



### EBITDA By Asset Class



■  
26%  
International  
Equity

■  
14%  
Alternative

■  
32%  
U.S. Growth  
Equity

■  
21%  
U.S. Value  
Equity

■  
7%  
Fixed Income,  
Balanced,  
Other

Friess Associates is widely known as the advisor to the highly-rated Brandywine family of mutual funds, each of which is rated four- or five-stars by Morningstar, and for its investment research designed to identify rapidly-growing companies whose stocks sell at reasonable price-to-earnings ratios. In addition, Friess has continued to expand its institutional and high net worth business, with significant growth due to the outstanding performance of its products.

Frontier and TimesSquare are among the industry's leading small-cap growth managers, and have extended their disciplined growth strategies to include small/mid-, mid-cap, and (in the case of Frontier) large-cap equities. Frontier's small-cap growth product has a strong long-term performance record, outpacing the Russell 2000 Growth index by more than 300 basis points and 1200 basis points annually over the prior three- and five-year periods, respectively. TimesSquare has achieved excellent returns for investors in its growth equity products, as the firm's small-cap growth product has outperformed the Russell 2000 Growth index by over 850 basis points on an annualized basis since its inception in 1986, and its small/mid-cap growth product has generated annualized returns of more than 1300 basis points above the Russell 2500 Growth index since its inception in 1985.

Essex, one of the pioneers of aggressive growth stock investing, uses an active portfolio management approach to identify investment opportunities based on anticipated changes at the industry and company level. Its Essex Growth Equity product applies the firm's strong fundamental research to uncover superior growth opportunities irrespective of a company's market capitalization, and in 2004, outperformed its Russell 3000 Growth index benchmark by over 500 basis points.



### U.S. Value Equity

AMG's Affiliates also include some of the industry's most experienced and respected practitioners of value style investing, such as Tweedy, Browne, Third Avenue, and Systematic Financial Management. These and other AMG Affiliates' high-quality value products provided approximately 21 percent of AMG's EBITDA at the end of 2004.



## INSTITUTIONAL DISTRIBUTION CHANNEL

AMG's Affiliates offer more than 100 investment products across more than 30 different investment styles in the institutional distribution channel, including small-, small/mid-, mid- and large-cap value, growth equity and emerging markets. In addition, AMG's Affiliates offer quantitative, alternative and fixed income products. AMG's Affiliates manage assets for a broad range of clients in this channel, including foundations and endowments, defined benefit and defined contribution plans for corporations and municipalities, and Taft-Hartley plans, with disciplined and focused investment styles that address the specialized needs of institutional clients.

AMG's institutional investment products are distributed by over 50 sales and marketing professionals at its Affiliates who develop new institutional business through direct sales efforts and established relationships with pension consultants. AMG works with its Affiliates in executing and enhancing their marketing and client service initiatives, with a focus on ensuring that its Affiliates' products and services successfully address the specialized needs of their clients and are responsive to the evolving demands of the marketplace. AMG also provides its Affiliates with resources to improve sales and marketing materials, network with the pension consultant and plan sponsor communities, and further expand and establish new distribution alternatives.

### EBITDA By Asset Class



26%  
International  
Equity

14%  
Alternative

32%  
U.S. Growth  
Equity

21%  
U.S. Value  
Equity

7%  
Fixed Income,  
Balanced,  
Other

Tweedy, Browne, a leading practitioner of the Graham and Dodd approach to value investing, manages U.S. equity products including the Tweedy, Browne American Value Fund, as well as individual accounts for institutional and high net worth investors. Tweedy, Browne's U.S. equity approach continues to deliver outstanding long-term results, outperforming the S&P 500 by more than 250 basis points on an annualized basis since its inception almost 30 years ago.

Third Avenue's "safe and cheap" investment philosophy, which seeks to invest in securities and companies at a deep discount to the intrinsic value of their assets, has created superior returns for its investors over the long-term. The Third Avenue Value and Third Avenue Small-Cap Value funds each have four-star Morningstar ratings, and the Third Avenue Value Fund has outperformed the S&P 500 by more than 1000 basis points annually in each of the past one-, three- and five-year periods.

Systematic's strategy of investing in undervalued companies with both low forward price-to-earnings ratios and a positive earnings catalyst is also producing superior results. The firm's Large Cap Value Earnings Surprise product has outperformed its peer group on an annualized basis over the past one-, three- and five-year periods.



### Fixed Income, Balanced and Other Products

In addition to their specialized expertise in equity and alternative products, a number of AMG's Affiliates, including Managers Investment Group, Davis Hamilton, and Renaissance Investment Management, offer fixed income and other products to their mutual fund, institutional and high net worth clients. Together, these products accounted for seven percent of AMG's EBITDA at the end of 2004. As an example, The Managers Funds, a broadly diversified family of mutual funds distributed by Managers Investment Group, includes a number of high-quality fixed income funds which were recently recognized by Lipper as the "Best Fixed Income Group" among smaller fund families for 2004.



Three yellow race cars, likely NASCAR stock cars, are shown on a dark track. The car in the foreground is a Chevrolet with the number 14 on its side and hood. Two other similar cars are visible behind it, slightly out of focus. The scene is lit with a warm, yellowish light, possibly from trackside lighting.

## HIGH NET WORTH DISTRIBUTION CHANNEL

AMG's Affiliates serve two principal client groups in the high net worth distribution channel. The first group consists principally of direct relationships with ultra high net worth and affluent individuals and families and charitable foundations. For these clients, AMG's Affiliates provide investment management or customized investment counseling and fiduciary services.

The second group consists of individual managed account client relationships established through intermediaries, generally brokerage firms or other sponsors. AMG's Affiliates provide investment management services through more than 90 managed account programs. Through Managers Investment Group, AMG provides its Affiliates with enhanced managed account distribution and administration capabilities for the distribution of single- and multi-manager separate account products and mutual funds through brokerage firms.

A blue and white race car with the number 8 is shown from a low angle, moving towards the right. A person in a blue jacket is waving a checkered flag in the upper left corner. The car has a large white number 8 on its side. The background is a dark asphalt track with a yellow line.

WHILE AMG'S AFFILIATES HAVE INDEPENDENTLY

DEMONSTRATED THE ABILITY TO ACHIEVE STRONG

BUSINESS RESULTS, AMG PROVIDES THE

RESOURCES AND SCALE TO FURTHER ENHANCE THEIR

GROWTH AND PROFITABILITY.





## **GROWTH AND DEVELOPMENT INITIATIVES**

While AMG's Affiliates have independently demonstrated the ability to achieve strong business results, AMG provides the resources and scale to further enhance their growth and profitability. This includes developing industry-leading platforms and initiatives that can expand product offerings, operations and distribution capabilities.

In 2004, AMG launched Managers Investment Group to expand its Affiliates' product offerings and distribution capabilities into the retail brokerage and intermediary marketplace, where scale and quality of execution in sales, support and back-office requirements are essential for success. Managers Investment Group operates a robust distribution and service platform for retail intermediaries, offering more than 75 institutional-quality mutual fund and separate account products to investors through banks, brokerage firms, insurance companies and other sponsored platforms, such as defined contribution plans. With offices in Connecticut, Chicago, Philadelphia, and San Francisco, Managers Investment Group's nationwide sales coverage is led by an experienced management team and includes more than 30 seasoned sales professionals.

As the regulatory climate in the investment management industry has continued to increase in complexity, AMG has significantly expanded its centralized legal and compliance resources. Offering robust, leading-edge compliance capabilities to its Affiliates, this initiative brings the knowledge and experience of senior AMG attorneys and compliance professionals with significant investment management, mutual fund, SEC and general counseling experience to AMG's Affiliates, providing industry expertise at a level well beyond that which would be typically available to mid-sized firms.

While AMG is fundamentally committed to preserving each Affiliate's unique culture and distinct operating identity, it brings the value of the combined resources and expertise of a broad, diversified asset management firm to its Affiliates' businesses in a number of other marketing, operational and strategic areas. Support for Affiliates ranges from direct involvement by AMG management (for example, recruiting for Affiliates or providing input on strategic matters) to coordinating services from marketing and operational consultants, to supporting Affiliates in their acquisitions of smaller firms or investment teams.





INVESTMENTS IN  
NEW AFFILIATES

In addition to the organic growth generated by AMG’s existing Affiliates, AMG has significant incremental growth opportunities through accretive investments in new Affiliates selected from among the highest-quality mid-sized investment management firms.

AMG’s proven investment strategy provides Affiliate managers with direct equity in their firm, creating a powerful incentive for long-term financial and investment performance. This approach preserves the entrepreneurial culture that characterizes the best mid-sized asset

management firms, while also providing access to the resources and distribution capabilities of a larger asset management company. It also attracts new Affiliates that value their individualism and their continued participation in their firm’s future growth.

AMG had an excellent year for new investments in 2004, investing in three high-quality, mid-sized asset management firms, each of which is a leading specialist in its distinct discipline, and brings additional diversification and growth potential to AMG’s business.

In November, AMG completed the acquisition of a significant minority interest in AQR Capital Management. Greenwich, Connecticut-based AQR is a fast-growing, quantitatively-focused firm with \$13 billion in assets under management, over half of which are in its leading hedge fund products. AQR serves more than 500 clients with its quantitative hedge fund and long-only international

equity products provided through collective investment vehicles and separate accounts. Since its founding in 1998, AQR has recorded 48 percent compound annual growth in assets under management through investment performance and net client cash flows. AQR further diversifies AMG’s overall profile, adding hedge fund strategies that have a low correlation with equity indices as well as products that invest in international equities.



Products:	Quantitative and Hedge Fund strategies <ul style="list-style-type: none"><li>Long-only EAFE product</li><li>Hedge funds managed for absolute return in 17 distinct strategies</li></ul>
AUM:	\$13 billion
Growth:	48% CAGR since 1998
Distribution Channels:	Institutional and High Net Worth
Location:	Greenwich, CT
Employees:	80

A high-angle, dynamic shot of two NASCAR-style race cars on a dark asphalt track. The car in the upper half is white with a red hood and blue front fenders, featuring the number 38 in large red digits. The car in the lower half is black with a yellow roof and yellow side panels, featuring the number 30 in large white digits. Both cars are angled towards the left, suggesting a turn. A vertical green line runs down the center of the image, separating the two cars. At the bottom, four horizontal green bars contain white text.

AMG'S PROVEN INVESTMENT STRATEGY

PROVIDES AFFILIATE MANAGERS WITH DIRECT EQUITY

IN THEIR FIRM, CREATING A POWERFUL INCENTIVE FOR

LONG-TERM FINANCIAL AND INVESTMENT PERFORMANCE.





WITH THE CONTINUED GROWTH AND SUCCESS OF EXISTING AFFILIATES,

AS WELL AS AMG'S REPUTATION AS AN INNOVATIVE

AND SUPPORTIVE PARTNER, AMG IS CONFIDENT OF ITS

ABILITY TO CONTINUE TO MAKE ACCRETIVE INVESTMENTS IN

ADDITIONAL AFFILIATES IN THE FUTURE.



In June, AMG completed the acquisition of a 60 percent interest in Genesis Fund Managers, a leading manager of emerging markets equity securities with principal operations in London, as well as offices in Chile and Guernsey. The investment, AMG's first outside of the U.S., provides meaningful participation in emerging markets equity investments and expands AMG's international institutional client base. Founded in 1989, Genesis employs a bottom-up research and stock selection process and seeks capital growth while limiting country risk through geographic diversification. Genesis manages approximately \$11 billion in assets in separate accounts, commingled portfolios and closed-end funds for institutional clients in the U.S., Europe and Australia.



<b>Products:</b>	Emerging Markets Equities
<b>AUM:</b>	\$11 billion
<b>Growth:</b>	35% CAGR since 1989
<b>Distribution Channel:</b>	Institutional
<b>Location:</b>	London, Guernsey and Chile
<b>Employees:</b>	70

AMG's third Affiliate investment in 2004 was in the equity business of New York-based TimesSquare Capital Management, a premier investment manager in small- and mid-cap growth. TimesSquare's outstanding equity investment team manages approximately \$5.5 billion on behalf of approximately 100 institutional clients, including public and corporate pension funds, endowments and foundations, and Taft-Hartley retirement plans. Since 2000, TimesSquare has achieved compound annual growth in assets under management of approximately 27 percent, building diversified portfolios of superior growth companies using their proven proprietary fundamental research process. By partnering with AMG to acquire their firm from its insurance company parent, TimesSquare's management team was able to acquire a substantial portion of the equity in their business, and to retain the unique investment culture and approach they have been practicing since 1984.



<b>Products:</b>	Growth Equity <ul style="list-style-type: none"> <li>• Small-, small/mid-, and mid-cap products</li> </ul>
<b>AUM:</b>	\$5.5 billion
<b>Growth:</b>	27% CAGR since 2000
<b>Distribution Channels:</b>	Institutional and Mutual Fund
<b>Location:</b>	New York, NY
<b>Employees:</b>	20

AMG also continues to make acquisitions to increase the scale of its existing businesses, adding to The Managers Funds family of sub-advised mutual funds through its acquisition of \$3 billion in assets under management in the Fremont Funds and \$400 million in assets under management in the Consecro Funds.

Looking ahead, AMG continues to identify and develop relationships with high-quality domestic and international mid-sized firms with between \$1 billion to \$25 billion of assets under management. AMG is well-positioned to execute such investments, having established relationships with more than 700 firms within its universe of target firms. With the continued growth and success of existing Affiliates, as well as AMG's reputation as

an innovative and supportive partner, AMG is confident of its ability to continue to capitalize on these relationships by making accretive investments in additional Affiliates in the future. Additionally, as international markets in Europe and Asia continue to mature and as alternative asset classes continue to grow and institutionalize, AMG expects substantial additional opportunities for attractive new Affiliate investments in these emerging segments of the asset management industry.



## **FINANCIAL STRENGTH**

AMG's business is distinguished by its strong and recurring free cash flow generated by the Company's broad participation in the asset management business with diverse investment products and distribution channels. AMG takes a disciplined approach to investing its free cash flow and adheres to well-defined return objectives in making investments in growth initiatives on behalf of existing Affiliates, as well as in executing investments in new Affiliates.

AMG supports its growth by maintaining a strong balance sheet and an efficient capital structure focused on supplementing its consistent cash flow from operations with a prudent level of debt. The Company maintains an investment-grade rating and seeks to ensure substantial liquidity and financial flexibility, while minimizing its cost of capital. AMG is focused on maximizing shareholder value by managing its capital resources and cash flow to achieve superior long-term results, by financing new investments, repaying indebtedness and repurchasing its stock, as appropriate.

*\* For more information regarding investment products and performance and comparative data, please see notes on page 82.*

AMG'S BUSINESS IS DISTINGUISHED BY ITS STRONG AND RECURRING

FREE CASH FLOW GENERATED BY THE COMPANY'S BROAD

PARTICIPATION IN THE ASSET MANAGEMENT BUSINESS WITH

DIVERSE INVESTMENT PRODUCTS AND DISTRIBUTION CHANNELS.

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## INVESTMENT PRODUCTS AND DISTRIBUTION CHANNELS

### INVESTMENT PRODUCTS

International Equity	Alternative	U.S. Growth Equity	U.S. Value Equity	Fixed Income
AQR	AQR	Davis Hamilton	First Quadrant	Davis Hamilton
Genesis	Essex	Essex	Frontier	Essex
Managers Investment Group	First Quadrant	Friess	Managers Investment Group	Managers Investment Group
Renaissance	Renaissance	Frontier	Rorer	Renaissance
Third Avenue	Third Avenue	J.M. Hartwell	Skyline	Rorer
Tweedy, Browne		Managers Investment Group	Systematic	
		Renaissance	Third Avenue	
		TimesSquare	Tweedy, Browne	

### DISTRIBUTION CHANNELS

Mutual Fund		Institutional		High Net Worth	
Davis Hamilton	Rorer	AQR	Renaissance	Davis Hamilton	Managers Investment Group
Essex	Skyline	Davis Hamilton	Rorer	Essex	Renaissance
First Quadrant	Systematic	Essex	Skyline	First Quadrant	Rorer
Friess	Third Avenue	First Quadrant	Systematic	Friess	Systematic
Managers Investment Group	TimesSquare	Friess	Third Avenue	Frontier	Third Avenue
Renaissance	Tweedy, Browne	Frontier	TimesSquare	Gofen and Glossberg	Tweedy, Browne
		Genesis	Tweedy, Browne	J.M. Hartwell	Welch & Forbes
		Gofen and Glossberg	Welch & Forbes		
		J.M. Hartwell			

# Financial Information

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# Management's Discussion and Analysis of Financial Condition and Results of Operations

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## Forward-Looking Statements

*When used in this Annual Report and in our filings with the Securities and Exchange Commission, in our press releases and in oral statements made with the approval of an executive officer, the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "may," "intends," "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, among others, the following:*

- *our performance is directly affected by changing conditions in the financial markets generally and in the equity markets particularly, and a decline or a lack of sustained growth in these markets may result in decreased advisory fees or performance fees and a corresponding decline (or lack of growth) in our operating results and in the cash flow distributable to us from our Affiliates;*
- *we cannot be certain that we will be successful in finding or investing in additional investment management firms on favorable terms, or that existing and new Affiliates will have favorable operating results;*
- *we may need to raise capital by making long-term or short-term borrowings or by selling shares of our common stock or other securities in order to finance investments in additional investment management firms or additional investments in our existing Affiliates, and we cannot be sure that such capital will be available to us on acceptable terms, if at all; and*
- *those certain other factors discussed under the caption "Business—Cautionary Statements," which are set forth in our 2004 Annual Report on Form 10-K.*

*These factors (among others) could affect our financial performance and cause actual results to differ materially from historical earnings and those presently anticipated and projected. 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. In that respect, we wish to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made.*

## Overview

We are an asset management company with equity investments in a diverse group of mid-sized investment management firms (our "Affiliates"). As of December 31, 2004, our affiliated investment management firms managed approximately \$129.8 billion in assets across a broad range of investment styles and in three principal distribution channels: Mutual Fund, Institutional and High Net Worth. We pursue a growth strategy designed to generate shareholder value through the internal growth of our existing business across these three channels, in addition to investments in mid-sized investment management firms and strategic transactions and relationships designed to enhance our Affiliates' businesses and growth prospects.

Through our Affiliates, we provide more than 175 investment products across a broad range of asset classes and investment styles in our three principal distribution channels. We believe that our diversification across asset classes, investment styles and distribution channels helps to mitigate our exposure to the risks created by changing market environments. The following summarizes our operations in our three principal distribution channels.

- Our Affiliates provide advisory or sub-advisory services to more than 50 mutual funds. These funds are distributed to retail and institutional clients directly and through



intermediaries, including independent investment advisors, retirement plan sponsors, broker/dealers, major fund marketplaces and bank trust departments.

- Through our Affiliates, we offer more than 100 investment products across more than 30 different investment styles in the Institutional distribution channel, including small, small/mid, mid and large capitalization value, growth equity and emerging markets. In addition, our Affiliates offer quantitative, alternative and fixed income products. Through this distribution channel, our Affiliates manage assets for foundations and endowments, defined benefit and defined contribution plans for corporations and municipalities, and Taft-Hartley plans, with disciplined and focused investment styles that address the specialized needs of institutional clients.
- The High Net Worth distribution channel is comprised broadly of two principal client groups. The first group consists principally of direct relationships with ultra high net worth and affluent individuals and families and charitable foundations. For these clients, our Affiliates provide investment management or customized investment counseling and fiduciary services. The second group consists of individual managed account client relationships established through intermediaries, generally brokerage firms or other sponsors. Our Affiliates provide investment management services through more than 90 managed account programs.

In January 2005, we completed the formation of Managers Investment Group LLC (“Managers” or “Managers Investment Group,” the successor to The Managers Funds LLC), a distribution platform designed to expand our Affiliates’ product offerings and distribution capabilities by leveraging our product development, packaging, sales and support expertise. Managers operates as a single point of contact for

retail intermediaries, offering more than 75 Affiliate products to mutual fund and separate account investors through banks, brokerage firms, insurance companies, and other sponsored platforms such as defined contribution plans. Managers has offices located throughout the United States, and is supported by a broad and experienced marketing and wholesaling team, which includes a significant external and internal sales force dedicated to providing sales and client services support.

While we operate our business through our Affiliates in our three principal distribution channels, we strive to maintain each Affiliate’s distinct entrepreneurial culture and independence through our investment structure. Our principal investment structure involves the ownership of a majority interest in our Affiliates, with each Affiliate organized as a separate firm. Each Affiliate operating agreement is tailored to meet that Affiliate’s particular characteristics and to enable us to cause or prevent certain actions to protect our interests.

We have revenue sharing arrangements with most of our Affiliates. Under these arrangements, a percentage of revenue (or in certain cases different percentages relating to the various sources or amounts of revenue of a particular Affiliate) is allocated for use by management of that Affiliate in paying operating expenses of the Affiliate, including salaries and bonuses. We call this the “Operating Allocation.” The portion of the Affiliate’s revenue that is allocated to the owners of that Affiliate (including us) is called the “Owners’ Allocation.” Each Affiliate allocates its Owners’ Allocation to its managers and to us generally in proportion to their and our respective ownership interests in that Affiliate. Where we hold a minority equity interest, our revenue sharing arrangement does not include an Operating Allocation or Owners’ Allocation. In these cases, we are generally allocated a percentage of the Affiliate’s revenue with the balance to be used to pay operating expenses and profit distributions to the other owners.

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We agree to a particular revenue sharing arrangement if we believe that the Operating Allocation will cover operating expenses of the Affiliate, including in the event of a potential increase in expenses or a decrease in revenue without a corresponding decrease in operating expenses. To the extent that we are unable to anticipate changes in the revenue and expense base of an Affiliate, the agreed-upon Operating Allocation may not be large enough to pay for all of the Affiliate's operating expenses. The allocations and distributions of cash to us under the Owners' Allocation generally have priority over the allocations and distributions to the Affiliate's managers, which helps to protect us if there are any expenses in excess of the Operating Allocation of the 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 managers until that portion is eliminated, and then reduce the portion allocated to us. Any such reduction in our portion of the Owners' Allocation is required to be paid back to us out of the portion of future Owners' Allocation allocated to the Affiliate's managers. Nevertheless, we may agree to adjustments to revenue sharing arrangements to accommodate our business needs or those of our Affiliates, including deferring or foregoing the receipt of some portion or all of our share of an Affiliate's revenue to permit the Affiliate to fund operating expenses or restructuring our relationship with an Affiliate, if we believe that doing so will maximize the long-term benefits to us. In addition, a revenue sharing arrangement may be modified to a profit-based arrangement (as described below) to accommodate better our business needs or those of our Affiliates.

One of the purposes of our revenue sharing arrangements is to provide ongoing incentives for Affiliate managers by allowing them:

- to participate in the growth of their firm's revenue, which may increase their compensation from the Operating Allocation and their distributions from the Owners' Allocation; and
  - to control operating expenses, thereby increasing the portion of the Operating Allocation that is available for growth initiatives and compensation.
- For the year ended December 31, 2004, approximately \$102.9 million was reported as compensation to our Affiliate managers. Additionally, during this period we allocated approximately \$115.5 million of our Affiliates' profits to their managers (referred to on our income statement as "minority interest").
- Some of our Affiliates are not subject to a revenue sharing arrangement, but instead operate on a profit-based model similar to a wholly-owned subsidiary. In our profit-based Affiliates, we participate in a budgeting process with the Affiliate and receive as cash flow a share of its profits. As a result, we participate fully in any increase or decrease in the revenue or expenses of such firms. In these cases, we generally provide incentives to management through compensation arrangements based on the performance of the Affiliate. In recent periods, approximately 15% of our earnings has been generated through our profit-based arrangements.
- Net Income on our income statement reflects the revenue of our majority-owned Affiliates and our share of income from Affiliates in which we own a minority equity interest, reduced by:
- the operating expenses of our majority-owned Affiliates;
  - our operating expenses (i.e., our holding company expenses, including interest, amortization, income taxes and compensation for our employees); and
  - the profits allocated to managers of our majority-owned Affiliates (i.e., minority interest).

As discussed above, for Affiliates with revenue sharing arrangements, the operating expenses of the Affiliate as well as its managers' minority interest generally increase (or decrease) as the Affiliate's revenue increases (or decreases) because of the direct relationship established in many of our agreements between the Affiliate's revenue and its Operating Allocation and Owners' Allocation. At our profit-based Affiliates, expenses may or may not correspond to increases or decreases in the Affiliates' revenues.

Our level of profitability will depend on a variety of factors, including:

- those affecting the financial markets generally and the equity markets particularly, which could potentially result in considerable increases or decreases in the assets under management at our Affiliates;
- the level of Affiliate revenue, which is dependent on the ability of our existing 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;
- our receipt of Owners' Allocation from Affiliates with revenue sharing arrangements, which depends on the ability of our existing and future Affiliates to maintain certain levels of operating profit margins;
- the increases or decreases in the revenue and expenses of Affiliates that operate on a profit-based model;
- the availability and cost of the capital with which we finance our existing and new investments;

- our success in making new investments and the terms upon which such transactions are completed;
- the level of intangible assets and the associated amortization expense resulting from our investments;
- the level of expenses incurred for holding company operations, including compensation for our employees; and
- the level of taxation to which we are subject.

Through our affiliated investment management firms, we derive most of our revenue from the provision of investment management services. Investment management fees ("asset-based fees") are usually determined as a percentage fee charged on periodic values of a client's assets under management and most asset-based advisory fees are billed by our Affiliates quarterly. Certain clients are billed for all or a portion of their accounts based upon assets under management valued at the beginning of a billing period ("in advance"). Other clients are billed for all or a portion of their accounts based upon assets under management valued at the end of the billing period ("in arrears"). For example, most client accounts in the High Net Worth distribution channel are billed in advance, and most client accounts in the Institutional distribution channel are billed in arrears. Clients in the Mutual Fund distribution channel are billed based upon average daily assets under management. 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, in the High Net Worth and Institutional distribution channels, certain clients are billed on the basis of investment performance



(“performance fees”). Performance fees are inherently dependent on investment results and therefore may vary substantially from year to year.

Principally, our assets under management are directly managed by our Affiliates. One of our Affiliates also manages assets in the Institutional distribution channel using an overlay strategy. Overlay assets (assets that are managed subject to strategies which employ futures, options or other derivative securities) generate asset-based fees that are typically substantially lower than the asset-based fees generated by our Affiliates’ other investment strategies. Therefore, changes in directly managed assets generally have a greater impact on our revenue from asset-based fees than changes in total assets under management (a figure which includes overlay assets).

In addition to the revenue derived from providing investment management services, we derive a small portion of our revenue from transaction-based brokerage fees and distribution fees at certain Affiliates. In the case of the transaction-based brokerage business at Third Avenue Management LLC (“Third Avenue”), our percentage participation in Third Avenue’s brokerage fee revenue is substantially less than our percentage participation in the investment management fee revenue realized by Third Avenue and our other Affiliates. For this reason, increases or decreases in our consolidated revenue that are attributable to Third Avenue brokerage fees will not affect our earnings in the same manner as investment management services revenue from Third Avenue and our other Affiliates.

## Results of Operations

The following tables present our Affiliates’ reported assets under management by operating segment (which are also referred to as distribution channels in this Annual Report) and a statement of changes for each period.

### Assets under Management — Operating Segment

	At December 31,		
<i>(dollars in billions)</i>	2002	2003	2004
Mutual Fund	\$ 16.4	\$ 23.3	\$ 29.9
Institutional	33.8	44.7	79.4
High Net Worth	20.6	23.5	20.5
	<u>\$ 70.8</u>	<u>\$ 91.5</u>	<u>\$ 129.8</u>
Directly managed assets – percent of total	91%	91%	92%
Overlay assets – percent of total	9%	9%	8%
	<u>100%</u>	<u>100%</u>	<u>100%</u>

### Assets under Management — Statement of Changes

	Year Ended December 31,		
<i>(dollars in billions)</i>	2002	2003	2004
Beginning of period	\$ 81.0	\$ 70.8	\$ 91.5
New investments <sup>(1)</sup>	4.6	—	25.2
Sale of Affiliate equity investment <sup>(2)</sup>	(1.0)	—	—
Net client cash flows – directly managed assets	0.3	1.7	(0.9)
Net client cash flows – overlay assets	(1.1)	0.4	0.1
Investment performance	(13.0)	18.6	13.9
End of period	<u>\$ 70.8</u>	<u>\$ 91.5</u>	<u>\$ 129.8</u>

(1) We closed new Affiliate investments in Third Avenue in August 2002, Genesis Fund Managers, LLP in June 2004 and TimesSquare Capital Management, LLC and AQR Capital Management, LLC in November 2004. Additionally, we acquired the retail mutual fund business of Conseco Capital Management, Inc. through Managers Investment Group LLC in March 2004.

(2) In the second quarter of 2002, we sold our minority equity interest in Paradigm Asset Management, L.L.C.

The operating segment analysis presented in the following table is based on average assets under management. For the Mutual Fund distribution channel, average assets under management represents an average of the daily net assets under management. For the Institutional and High Net Worth distribution channels, average assets under management

represents an average of the assets at the beginning and end of each calendar quarter during the applicable period. We believe that this analysis more closely correlates to the billing cycle of each distribution channel and, as such, provides a more meaningful relationship to revenue.

<i>(in millions, except as noted)</i>	2002	2003	% Change	2004	% Change
<b>Average Assets under Management (in billions)<sup>(1)</sup></b>					
Mutual Fund	\$ 15.4	\$ 18.6	21%	\$ 25.6	38%
Institutional	37.7	38.0	1%	53.4	41%
High Net Worth	22.5	21.4	(5%)	21.9	2%
Total	\$ 75.6	\$ 78.0	3%	\$ 100.9	29%
<b>Revenue<sup>(2)</sup></b>					
Mutual Fund	\$ 164.6	\$ 191.7	16%	\$ 255.1	33%
Institutional	178.1	171.8	(4%)	265.8	55%
High Net Worth	139.8	131.5	(6%)	139.1	6%
Total	\$ 482.5	\$ 495.0	3%	\$ 660.0	33%
<b>Net Income<sup>(2)</sup></b>					
Mutual Fund	\$ 22.8	\$ 28.7	26%	\$ 36.5	27%
Institutional	16.3	15.8	(3%)	27.3	73%
High Net Worth	16.8	16.0	(5%)	13.3	(17%)
Total	\$ 55.9	\$ 60.5	8%	\$ 77.1	27%
<b>EBITDA<sup>(2)(3)</sup></b>					
Mutual Fund	\$ 47.8	\$ 59.0	23%	\$ 75.4	28%
Institutional	48.9	48.1	(2%)	72.7	51%
High Net Worth	42.1	40.1	(5%)	38.3	(4%)
Total	\$ 138.8	\$ 147.2	6%	\$ 186.4	27%

- (1) Assets under management attributable to investments that closed during the relevant periods are included on a weighted average basis for the period from the closing date of the respective investment. Average assets under management includes assets managed by affiliated investment management firms that we do not consolidate for financial reporting purposes of \$1.0 billion, \$0.2 billion and \$1.6 billion for 2002, 2003 and 2004, respectively.
- (2) Note 20 to the Consolidated Financial Statements describes the basis of presentation of the financial results of our three operating segments. As discussed in Note 13 to the Consolidated Financial Statements, we are required to use the equity method of accounting for our investment in AQR and as such do not consolidate their revenue for financial reporting purposes. Our share of AQR's profits is reported in "Investment and other income" and is therefore reflected in Net Income and EBITDA.
- (3) EBITDA represents earnings before interest expense, income taxes, depreciation and amortization. As a measure of liquidity, we believe that EBITDA is useful as an indicator of our ability to service debt, make new investments and meet working capital requirements. EBITDA is not a measure of liquidity under generally accepted accounting principles and should not be considered an alternative to cash flow from operations. EBITDA, as calculated by us, may not be consistent with computations of EBITDA by other companies. Our use of EBITDA, including a reconciliation to cash flow from operations, is discussed in greater detail in "Liquidity and Capital Resources." For purposes of our distribution channel operating results, holding company expenses have been allocated based on the proportion of aggregate cash flow distributions reported by each Affiliate in the particular distribution channel.

## Revenue

Our revenue is generally determined by the following factors:

- our assets under management (including increases or decreases relating to new investments, net client cash flows or changes in the value of assets that are attributable to fluctuations in the equity markets);
- the portion of our assets across the three operating segments and our Affiliates, which realize different fee rates;
- the portion of our directly managed and overlay assets, which realize different fee rates;
- the recognition of any performance fees; and
- the level of transaction-based brokerage fees.

In addition, the billing patterns of our Affiliates will have an impact on revenue in cases of rising or falling markets. As described previously, advisory fees billed in advance will not reflect subsequent changes in the market value of assets under management for that period, while advisory fees billed in arrears will reflect changes in the market value of assets under management for that period. As a consequence, when equity market declines result in decreased assets under management in a particular period, revenue reported on accounts that are billed in advance of that period may appear to have a relatively higher quarterly fee rate, and in the case of equity market appreciation, revenue reported on accounts that are billed in advance of that period may appear to have a relatively lower quarterly fee rate.

The increase in revenue of \$165.0 million (or 33%) in 2004 from 2003 resulted principally from a 29% increase in average assets under management. The increase in average assets

under management was primarily attributable to positive investment performance and, to a lesser extent, our new investments in 2004. Unrelated to the change in assets under management, the increase in revenue was also a result of higher performance fees in 2004 as compared to 2003.

The increase in revenue of \$12.5 million (or 3%) in 2003 from 2002 resulted principally from a 3% increase in average assets under management. The increase in average assets under management was primarily attributable to our investment in Third Avenue, which closed in the third quarter of 2002 and is included in our operating results for a full year in 2003. Unrelated to the change in assets under management, the increase was partially offset by lower performance fees in 2003 as compared to 2002.

The following discusses the changes in our revenue by operating segments.

### Mutual Fund Distribution Channel

The increase in revenue of \$63.4 million (or 33%) in the Mutual Fund distribution channel in 2004 from 2003 resulted principally from a 38% increase in average assets under management. The increase in average assets under management was primarily attributable to positive investment performance and, to a lesser extent, positive net client cash flows. The increase in revenue was proportionately less than the growth in average assets under management because of an increase in assets under management that realize a comparatively lower fee rate.

The increase in revenue of \$27.1 million (or 16%) in 2003 from 2002 resulted principally from a 21% increase in average assets under management. The increase in average assets under management was primarily attributable to our investment in Third Avenue in the third quarter of 2002 and, to a lesser extent, positive net client cash flows. The increase in revenue was proportionately less than the growth in average assets under management because of an increase in assets under management that realize a comparatively lower fee rate.



### Institutional Distribution Channel

The increase in revenue of \$94.0 million (or 55%) in the Institutional distribution channel in 2004 from 2003 resulted principally from a 41% increase in average assets under management. The increase in average assets under management was primarily attributable to positive investment performance and, to a lesser extent, our investments in new Affiliates and positive net client cash flows. The increase in revenue was proportionately greater than the growth in assets under management because of an increase in assets under management that realize a comparatively higher fee rate, as well as higher performance fees in 2004.

Revenue decreased by \$6.3 million (or 4%) in 2003 from 2002 despite a 1% increase in average assets under management. Lower performance fees in 2003 as compared to 2002 (which are unrelated to changes in assets under management) was the primary reason for the decline in revenue.

### Operating Expenses

The following table summarizes our consolidated operating expenses:

<i>(dollars in millions)</i>	2002	2003	% Change	2004	% Change
Compensation and related expenses	\$ 165.9	\$ 175.0	5%	\$ 241.6	38%
Selling, general and administrative	84.5	84.1	—%	109.1	30%
Amortization of intangible assets	14.5	16.2	12%	18.3	13%
Depreciation and other amortization	5.8	6.2	7%	6.4	3%
Other operating expenses	16.0	16.0	—%	16.7	4%
Total operating expenses	\$ 286.7	\$ 297.5	4%	\$ 392.1	32%

The substantial portion of our operating expenses is incurred by our Affiliates, and the substantial majority of Affiliate expenses is incurred at Affiliates with revenue sharing arrangements. For Affiliates with revenue sharing arrangements, an Affiliate's Operating Allocation percentage generally determines its operating expenses. Most notably, our compensation expenses are generally impacted by increases or decreases in each Affiliate's revenue and therefore by corresponding increases or decreases in their respective aggregate Operating Allocations. During the

### High Net Worth Distribution Channel

The increase in revenue of \$7.6 million (or 6%) in the High Net Worth distribution channel in 2004 from 2003 resulted principally from a 2% increase in average assets under management. The increase in average assets under management was primarily attributable to positive investment performance and was partially offset by net client cash outflows, primarily at Rorer Asset Management, LLC. The increase in revenue was proportionately greater than the growth in assets under management because of an increase in assets under management that realize a comparatively higher fee rate.

The decrease in revenue of \$8.3 million (or 6%) in 2003 from 2002 resulted principally from a 5% decline in average assets under management. The decrease in average assets under management was primarily attributable to the decline in the equity markets in 2002 through the first quarter of 2003, as well as net client cash outflows. This decrease in revenue was partially offset by our investment in Third Avenue in the third quarter of 2002.

year ended December 31, 2004, approximately \$102.9 million, or about 43% of our consolidated compensation expense, was attributable to compensation allocated to our Affiliate managers. As described previously, the percentage of revenue allocated to operating expenses varies from one Affiliate to another and can vary within an Affiliate depending on the source or amounts of revenue. As a result, changes in our aggregate revenue may not impact our consolidated operating expenses to the same degree. In contrast, at our profit-based Affiliates,

we participate fully in any increase or decrease in revenue and expenses.

Compensation and related expenses increased 38% in 2004, following a 5% increase in 2003. The increase in 2004 was primarily a result of the relationship between revenue and operating expenses at our Affiliates with revenue sharing arrangements, which experienced aggregate increases in revenue, and accordingly, reported higher compensation expenses. The increase was also related to \$20.0 million in aggregate Affiliate expenses from our new investments in 2004 (and the inclusion of the compensation expense for those Affiliates) as well as higher holding company compensation. The increase in 2003 resulted primarily from a \$14.7 million increase in aggregate Affiliate expenses from our investment in Third Avenue in 2002 (and the inclusion of compensation expense at Third Avenue in our operating results for the full year of 2003), and was partially offset by a decrease in compensation expenses of \$5.7 million at the holding company and our other Affiliates.

Selling, general and administrative expenses increased 30% in 2004. The increase was principally attributable to an \$11.9 million increase in sub-advisory and distribution expenses resulting from the growth in assets under management at our Affiliates in the Mutual Fund distribution channel. Also contributing to the increase were \$4.9 million in aggregate Affiliate expenses from our new investments in 2004 (and the inclusion of the additional expenses for those Affiliates) and \$3.8 million of professional fees associated with our Sarbanes-Oxley Act compliance and new investment activities at the holding company. Selling,

general and administrative expenses were flat in 2003 as the increase of \$6.8 million of selling, general and administrative expenses at Third Avenue for the inclusion of a full year of their expenses in 2003 was offset by a similar decrease in operating expenses at other Affiliates.

Amortization of intangible assets increased 13% in 2004. The increase in amortization expense was equally attributable to amortization relating to investments in new and existing Affiliates and changes in the remaining useful lives of our existing acquired client relationships which increased amortization expense. The increase in amortization of intangible assets of 12% in 2003 resulted from the inclusion of \$0.3 million of amortization expense for Third Avenue and changes in the remaining useful lives of our existing acquired client relationships.

Depreciation and other amortization expenses increased 3% in 2004 and 7% in 2003. The increases in both years were principally attributable to new investments and other fixed asset purchases at the holding company and other Affiliates.

Other operating expenses increased 4% in 2004, principally as a result of a \$1.5 million increase in occupancy costs and other expenses reported by new Affiliates in 2004 (and the inclusion of these expenses for those Affiliates), as well as a \$0.6 million one-time expense associated with an Affiliate lease termination. Other operating expenses were flat in 2003, as the effect of a full year of operating expenses associated with our investment in Third Avenue (which increased other operating expenses by \$1.0 million) was offset by lower expenses at other Affiliates.

### Other Income Statement Data

The following table summarizes other income statement data.

<i>(dollars in millions)</i>	2002	2003	% Change	2004	% Change
Investment and other income	\$ 3.5	\$ 8.2	134%	\$ 8.5	4%
Minority interest	80.8	81.0	—%	115.5	43%
Interest expense	25.2	23.0	(9%)	31.7	38%
Income tax expense	37.3	41.3	11%	51.9	26%

Investment and other income primarily consists of the following:

- our share of income from Affiliates in which we own a minority equity interest, net of any related intangible amortization;
- earnings on cash and cash equivalent balances; and
- earnings that Affiliates realize on any investments (in accordance with our Affiliate operating agreements, these earnings are generally allocated to our management partners and accordingly result in an increase in minority interest expense on our statement of operations).

Investment and other income increased 4% in 2004, following a 134% increase in 2003. The increase in 2004 was attributable to a \$2.7 million increase in Affiliate earnings on investments, \$1.3 million of income attributable to our investment in AQR and a \$0.9 million increase in holding company interest income. These increases were partially offset by a loss of \$2.5 million on our repurchase of \$154.3 million of the senior notes component of our 2001 PRIDES in August 2004 (as discussed below).

The increase in investment and other income in 2003 was primarily attributable to a one-time gain of approximately \$1.7 million attributable to an Affiliate's strategic alliance and a \$1.5 million increase in Affiliate earnings on investments. Additionally, the increase was related to an increase of \$0.7 million in holding company interest income from elevated cash holdings following our issuance of floating rate senior convertible securities in 2003 and a one-time gain of \$0.6 million from our repurchase of zero coupon senior convertible notes in 2003.

## Net Income

The following table summarizes Net Income for the past three years:

<i>(dollars in millions)</i>	2002	2003	% Change	2004	% Change
Net Income	\$ 55.9	\$ 60.5	8%	\$ 77.1	27%

Minority interest increased 43% in 2004, principally as a result of the previously discussed increase in revenue. During these periods, the percentage increase in minority interest was proportionately greater than the percentage increase in revenue because of an increase in revenue at profit-based Affiliates (which, as discussed above, do not necessarily result in proportionate changes in minority interest). Minority interest was flat in 2003, as the \$8.4 million increase in minority interest expense resulting from our investment in Third Avenue in 2002 was offset by a decrease of \$3.7 million resulting primarily from a decrease in revenue and an increase in investment spending of \$4.7 million at certain of our Affiliates.

Interest expense increased by \$8.7 million (or 38%) in 2004, following a 9% decrease in 2003. The increase in 2004 was principally attributable to \$10.9 million of interest expense in connection with our issuance of our 2004 PRIDES (as discussed below). This increase was offset by a \$3.5 million decrease in interest expense related to our repurchase of \$154.3 million of the senior notes component of our 2001 PRIDES in August 2004. The decrease in interest expense in 2003 was attributable to 2002 expenses that did not recur in 2003 (\$2.3 million of debt issuance cost amortization and \$1.5 million of interest rate derivative contracts settlements). The decreases in 2003 were partially offset by interest expense attributable to our floating rate senior convertible securities issued in February 2003.

The 26% increase in income tax expense in 2004 was principally attributable to an increase in income before taxes and was partially offset by a decrease in the effective tax rate. The 11% increase in income tax expense in 2003 was principally attributable to an increase in income before taxes.



Net Income increased 27% in 2004, principally as a result of the increases in revenue, partially offset by increases in reported operating, interest, minority interest and tax expenses, as described above. The 8% increase in Net Income in 2003 resulted primarily from increases in revenue and investment and other income and lower interest expense, offset partially by the increases in operating and income tax expenses, as described above. Net Income by segment is presented in Note 20 to the Consolidated Financial Statements.

### Supplemental Performance Measure

As supplemental information, we provide a non-GAAP performance measure that we refer to as Cash Net Income. This measure is provided in addition to, but not as a substitute for, Net Income. Cash Net Income is defined as Net Income plus amortization and deferred taxes related to intangible assets plus Affiliate depreciation. We consider Cash Net Income an important measure of our financial performance, as we believe it best represents operating performance before non-cash expenses relating to our acquisition of interests in our Affiliates. Cash Net Income is used by our management and Board of Directors as a principal performance benchmark, including as a measure for aligning executive compensation with stockholder value.

Since our acquired assets do not generally depreciate or require replacement by us, and since they generate deferred tax expenses that are unlikely to reverse, we add back these non-cash expenses to Net Income to measure operating performance. We add back amortization attributable to acquired client relationships because this expense does not correspond to the changes in value of these assets, which do not diminish predictably over time. The portion of deferred taxes generally attributable to intangible assets (including goodwill) that we no longer amortize but which continues to generate tax deductions is added back, because these accruals would be used only in the event of a future sale of an Affiliate or an impairment charge, which we consider unlikely. We add back the portion of consolidated depreciation expense incurred by our Affiliates because under our Affiliates' operating agreements we are generally not required to replenish

these depreciating assets. Conversely, we do not add back the deferred taxes relating to our floating rate senior convertible securities or other depreciation expenses.

The following table provides a reconciliation of Net Income to Cash Net Income:

<i>(dollars in millions)</i>	2002 <sup>(1)</sup>	2003	2004
<b>Net Income</b>	\$ 55.9	\$ 60.5	\$ 77.1
Intangible amortization	14.5	16.2	18.3
Intangible amortization – equity method investments <sup>(2)</sup>	—	—	0.9
Intangible-related deferred taxes	23.2	23.9	25.8
Affiliate depreciation	5.9	4.3	4.4
<b>Cash Net Income<sup>(1)</sup></b>	<b>\$ 99.5</b>	<b>\$ 104.9</b>	<b>\$ 126.5</b>

(1) In 2003, we modified the definition of Cash Net Income to clarify that deferred taxes relating to our 2003 issuance of convertible securities and certain depreciation are not added back for the calculation of Cash Net Income. If we had used this definition of Cash Net Income beginning in 2002, Cash Net Income for 2002 would have been \$97.6 million.

(2) As discussed in Note 13 to the Consolidated Financial Statements, we are required to use the equity method of accounting for our investment in AQR and as such do not consolidate their revenue or expenses, including intangible amortization expenses, in our income statement. Our share of AQR's amortization is reported in "Investment and other income."

Cash Net Income increased 21% in 2004 and 5% in 2003, primarily as a result of the previously described factors affecting Net Income.

### Liquidity and Capital Resources

Our capital structure includes a number of convertible instruments. Our zero coupon senior convertible notes and floating rate senior convertible securities are contingently convertible securities while our 2004 PRIDES (and previously, our 2001 PRIDES) are mandatory convertible securities. Our mandatory convertible securities are structured to issue additional equity at a pre-determined future date. Our contingently convertible securities are structured

to provide us with low cash interest payments (and in the case of the zero coupon senior convertible notes, no cash interest payments), and in the case of the floating rate senior convertible securities, significant tax benefits.

We view our ratio of debt to EBITDA (our “leverage ratio”) as an important gauge of our ability to service debt, make new investments and access capital. Consistent with industry practice, we do not consider our mandatory convertible security as debt for the purpose of determining our leverage ratio. As more fully discussed below, each unit of our 2004 PRIDES is comprised of a senior note and a forward purchase contract. Under the terms of the security, the exercise of the forward purchase contracts at the settlement date will result in the issuance of shares of our common stock that will generate cash proceeds sufficient to amortize debt in an amount equal to the remaining note portion of the security. We also view our leverage on a “net debt” basis by deducting our cash and cash equivalents from our debt balance. The leverage covenant of our senior bank facility is generally consistent with our treatment of the PRIDES security and our net debt approach. At December 31, 2004, our leverage ratio was 2.2:1.

The following table summarizes certain key financial data relating to our liquidity and capital resources:

<i>(dollars in millions)</i>	December 31,		
	2002	2003	2004
<b>Balance Sheet Data</b>			
Cash and cash equivalents	\$ 27.7	\$ 224.3	\$ 140.3
Short-term investments	—	29.1	21.2
Senior debt	—	—	126.8
Zero coupon convertible notes	229.0	123.3	124.0
Floating rate convertible securities	—	300.0	300.0
Mandatory convertible securities	230.0	230.0	300.0
<b>Cash Flow Data</b>			
Operating cash flows	\$ 127.3	\$ 116.5	\$ 177.9
Investing cash flows	(138.9)	(73.9)	(478.3)
Financing cash flows	(34.2)	153.7	215.2
EBITDA <sup>(1)</sup>	138.8	147.2	186.4

(1) The definition of EBITDA is presented in Note 3 on page 35.

## Supplemental Liquidity Measure

As supplemental information, we provide information regarding our EBITDA, a non-GAAP liquidity measure. This measure is provided in addition to, but not as a substitute for, cash flow from operations. EBITDA represents earnings before interest expense, income taxes, depreciation and amortization. EBITDA, as calculated by us, may not be consistent with computations of EBITDA by other companies. As a measure of liquidity, we believe that EBITDA is useful as an indicator of our ability to service debt, make new investments and meet working capital requirements. We further believe that many investors use this information when analyzing the financial position of companies in the investment management industry.

The following table provides a reconciliation of cash flow from operations to EBITDA:

<i>(dollars in millions)</i>	2002	2003	2004
<b>Cash Flow from Operations</b>	\$ 127.3	\$ 116.5	\$ 177.9
Interest expense, net of non-cash items	20.5	19.0	26.9
Current tax provision	14.1	10.3	20.3
Intangible amortization – equity method investments <sup>(1)</sup>	—	—	0.9
Changes in assets and liabilities and other adjustments	(23.1)	1.4	(39.6)
<b>EBITDA</b>	<b>\$ 138.8</b>	<b>\$ 147.2</b>	<b>\$ 186.4</b>

(1) As discussed in Note 13 to the Consolidated Financial Statements, we are required to use the equity method of accounting for our investment in AQR and as such do not consolidate their revenue or expenses, including intangible amortization, in our income statement. Our share of AQR’s amortization is reported in “Investment and other income.”

In 2004, we met our cash requirements primarily through cash generated by operating activities, the issuance of convertible debt securities and borrowings of senior debt. Our principal uses of cash were to make investments in new and existing Affiliates, repurchase shares of our common stock, repurchase debt securities and make distributions to

Affiliate managers. We expect that our principal uses of cash for the foreseeable future will be for investments in new and existing Affiliates, distributions to Affiliate managers, payment of principal and interest on outstanding debt, the repurchase of debt securities, the repurchase of shares of our common stock and for working capital purposes.

### Senior Revolving Credit Facility

In August 2004, we amended our senior revolving credit facility with a syndicate of major commercial banks, which previously allowed for borrowings of up to \$250 million. The amended credit facility (the “Facility”) extends the maturity date to August 2007 and currently provides that we may borrow up to \$405 million at rates of interest (based either on the Eurodollar rate or the prime rate as in effect from time to time) that vary depending on our credit ratings. Subject to the agreement of the lenders (or prospective lenders) to increase their commitments, we have the option to increase the Facility up to an aggregate of \$450 million. The Facility contains financial covenants with respect to net worth, leverage and interest coverage. The Facility also contains customary affirmative and negative covenants, including limitations on indebtedness, liens, cash dividends and fundamental corporate changes. Any borrowings under the Facility would be collateralized by pledges of all capital stock or other equity interests owned by us. At December 31, 2004, we had \$51 million outstanding under the Facility.

### Zero Coupon Senior Convertible Notes

In May 2001, we completed a private placement of zero coupon senior convertible notes. In this private placement, we sold an aggregate of \$251 million principal amount at maturity of zero coupon senior convertible notes due 2021, with each note issued at 90.50% of such principal amount and accreting at a rate of 0.50% per year. Each security is convertible into 17.429 shares of our common stock upon the occurrence of certain events, including the following: (i) if the closing price of a share of our common stock is more than a specified price over certain periods (initially \$62.36 and increasing incrementally at the end of each calendar

quarter to \$63.08 in April 2021); (ii) if the credit rating assigned by Standard & Poor’s to the securities is below BB-; or (iii) if we call the securities for redemption. The holders may require us to repurchase the securities at their accreted value in May 2006, 2011 and 2016. If the holders exercise this option in the future, we may elect to repurchase the securities with cash, shares of our common stock or some combination thereof. We have the option to redeem the securities for cash on or after May 7, 2006 at their accreted value. In 2003, we repurchased an aggregate \$116.5 million principal amount at maturity of zero coupon senior convertible notes in privately negotiated transactions and realized a gain of \$0.6 million, which was reported in “Investment and other income.” Under the terms of the indenture governing the zero coupon senior convertible notes, through March 31, 2005 a holder may convert such security into our common stock by following the conversion procedures in the indenture; the zero coupon senior convertible notes may cease to be convertible in the future.

### Floating Rate Senior Convertible Securities

In February 2003, we completed a private placement of \$300 million of floating rate senior convertible securities due 2033 (“floating rate convertible securities”). The floating rate convertible securities bear interest at a rate equal to three-month LIBOR minus 0.50%, payable in cash quarterly. Each security is convertible into shares of our common stock upon the occurrence of certain events, including the following: (i) if the closing price of a share of our common stock exceeds \$65.00 over certain periods; (ii) if the credit rating assigned by Standard & Poor’s is below BB-; or (iii) if we call the securities for redemption. Upon conversion, holders of the securities will receive 18.462 shares of our common stock for each convertible security. In addition, if the market price of our common stock exceeds \$54.17 per share at the time of conversion, holders will receive additional shares of common stock based on the stock price at that time. Based on the trading price of our common stock as of December 31, 2004, upon conversion a holder of each security would receive an additional 2.254 shares. The holders of the floating rate convertible securities may require us to



repurchase such securities in February 2008, 2013, 2018, 2023 and 2028, at their principal amount. We may choose to pay the purchase price for such repurchases with cash, shares of our common stock or some combination thereof. We may redeem the convertible securities for cash at any time on or after February 25, 2008, at their principal amount.

As further described in Note 10 to the Consolidated Financial Statements, we have entered into interest rate swap contracts to exchange a fixed rate for the variable rate on \$150 million of our floating rate senior convertible securities. For the period February 2005 through February 2008, we will pay a weighted average fixed rate of 3.28% on that notional amount.

The floating rate senior convertible securities are considered contingent payment debt instruments under federal income tax regulations. These regulations require us to deduct interest expense at the rate at which we would issue a non-contingent, non-convertible, fixed-rate debt instrument. When the implied interest rate for tax purposes is greater than the actual interest rate, a deferred tax expense is generated. While the implied interest rate for these securities for tax purposes is 5.62%, the actual rate is three-month LIBOR minus 0.50% (as of March 8, 2005, this rate equaled 2.47%). Based on current LIBOR rates, these securities generate approximately \$3.7 million of deferred taxes each year. While these deferred tax liabilities may never reverse, such liabilities will reverse if we redeem the securities on February 25, 2008 or later and if our common stock is trading at \$54.17 per share or less on the date of redemption. All deferred taxes related to the securities will be reclassified to equity if the securities convert and our common stock is trading at more than \$60.90 per share when it is delivered to holders.

#### **Senior Notes due 2006**

In December 2001, we completed a public offering of mandatory convertible securities ("2001 PRIDES"). A sale of an over-allotment of the securities was completed in January 2002, increasing the aggregate amount outstanding

to \$230 million. Each unit of the 2001 PRIDES initially consisted of (i) a senior note due November 17, 2006 with a principal amount of \$25 per note, on which we pay quarterly interest, and (ii) a forward purchase contract pursuant to which the holder agreed to purchase shares of our common stock on November 17, 2004, with the number of shares to be determined based upon the average trading price of our common stock for a period preceding that date.

In August 2004, we repurchased \$154.3 million in aggregate principal amount of the senior notes component of the 2001 PRIDES. We repurchased the notes through a tender offer, a privately negotiated purchase and certain repurchases in the August 2004 remarketing of the notes. We reported a loss of \$2.5 million on our repurchase of these notes, which was reported in "Investment and other income." In August 2004, we also settled \$39.3 million of the 2001 PRIDES forward purchase contracts and realized a gain of \$3.7 million, which was recorded directly to stockholders' equity. In connection with the settlement of the forward purchase contracts in November 2004, we issued 3.4 million shares of common stock and received \$190.8 million of gross proceeds.

Following these transactions, \$75.8 million in aggregate principal amount of the senior notes component of the 2001 PRIDES (the "Senior Notes due 2006") remain outstanding, with an interest rate of 5.41% and a maturity date of November 2006.

#### **2004 Mandatory Convertible Securities**

In February 2004, we completed a private placement of \$300 million of mandatory convertible securities ("2004 PRIDES"). As described below, these securities are structured to provide \$300 million of additional proceeds to us following a successful remarketing and the exercise of forward purchase contracts in February 2008.

Each unit of the 2004 PRIDES consists of (i) a senior note due February 2010 with a principal amount of \$1,000 per note, on which we pay interest quarterly at the

annual rate of 4.125%, and (ii) a forward purchase contract pursuant to which the holder has agreed to purchase shares of our common stock in February 2008. Holders of the purchase contracts receive a quarterly contract adjustment payment at the annual rate of 2.525% per \$1,000 purchase contract. The current portion of the contract adjustment payments, approximately \$7.0 million, is recorded in current liabilities. The number of shares to be issued in February 2008 will be determined based upon the average trading price of our common stock for a period preceding that date. Depending on the average trading price in that period, the settlement rate will range from 11.785 to 18.031 shares per \$1,000 purchase contract. Based on the trading price of the Company's common stock as of December 31, 2004, the purchase contracts would have a settlement rate of 14.762.

Each of the senior notes is pledged to us to collateralize the holder's obligations under the forward purchase contracts. Beginning in August 2007, under the terms of the 2004 PRIDES, the senior notes are expected to be remarketed to new investors. A successful remarketing will generate \$300 million of gross proceeds to be used by the original holders of the 2004 PRIDES to honor their obligations on the forward purchase contracts. In exchange for the additional \$300 million in payment on the forward purchase contracts, we will issue shares of our common stock to the original holders of the senior notes. As referenced above, the number of shares of common stock to be issued will be determined by the market price of our common stock at that time. Assuming a successful remarketing, the senior notes will remain outstanding until at least February 2010.

#### **Forward Equity Sale Agreement**

In October 2004, we entered into a forward equity sale agreement with a major securities firm. Under the terms of the agreement, we can elect to deliver a specified number of shares of common stock at any time until October 2005, in exchange for proceeds of approximately \$100 million.

Alternatively, we can cancel the transaction at any time. Upon cancellation, we may net settle the forward agreement in stock, cash, or a combination thereof. Under certain circumstances, we can be required to settle the forward equity sale agreement by delivering shares of common stock. We will not receive any proceeds from the sale of our common stock until settlement of all or a portion of the forward equity sale agreement. In connection with this agreement, our counterparty borrowed approximately 1.9 million shares of our common stock in the stock loan market and sold these shares pursuant to our existing shelf registration statement.

#### **Purchases of Affiliate Equity**

Our Affiliate operating agreements provide our Affiliate managers the conditional right to require us to purchase their retained equity interests at certain intervals. The agreements also provide us a conditional right to require Affiliate managers to sell their retained equity interests to us upon their death, permanent incapacity or termination of employment and provide Affiliate managers a conditional right to require us to purchase such retained equity interests upon the occurrence of specified events. These purchases may occur in varying amounts over a period of approximately 15 years (or longer), and the actual timing and amounts of such purchases (or the actual occurrence of such purchases) generally cannot be predicted with any certainty. These purchases are generally calculated based upon a multiple of the Affiliate's cash flow distributions, which is intended to represent fair value. As one measure of the potential magnitude of such purchases, in the event that a triggering event and resulting purchase occurred with respect to all such retained equity interests as of December 31, 2004, the aggregate amount of these payments would have totaled approximately \$710.8 million. In the event that all such transactions were closed, we would own the prospective cash flow distributions of all equity interests that would be purchased from our Affiliate managers. As of December 31, 2004, this amount would represent approximately \$100.3 million on an annualized basis. We pay for these purchases

in cash, shares of our common stock or other forms of consideration. With our approval, Affiliate managers are also permitted to sell their equity interests to other individuals or entities, subject to certain restrictions. These potential purchases, combined with our other cash needs, may require more cash than is available from operations, and therefore, we may need to raise capital by making borrowings under our Facility, by selling shares of our common stock or other equity or debt securities, or to otherwise refinance a portion of these purchases.

### **Operating Cash Flow**

Cash flow from operations generally represents net income plus non-cash charges for amortization, deferred taxes and depreciation as well as the changes from our consolidated working capital. The increase in cash flow from operations in 2004 from 2003 resulted principally from increases in net income and minority interest which resulted from growth in revenue reported in 2004 from 2003.

The decrease in cash flow from operations in 2003 from 2002 resulted principally from increases in receivables at December 31, 2003 from December 31, 2002 as a result of the growth in revenue reported in the fourth quarter of 2003.

### **Investing Cash Flow**

Changes in net cash flow from investing activities result primarily from our investments in new and existing Affiliates. Net cash flow used to make investments was \$136.5 million, \$19.1 million and \$474.1 million for the years ended December 31, 2002, 2003 and 2004, respectively. In 2002, we acquired a majority equity interest in Third Avenue and additional equity interests in existing Affiliates. In 2003, we made payments to acquire additional equity interests in existing Affiliates. In 2004, we acquired equity interests in Genesis, TimesSquare and AQR, and an additional equity interest in Friess Associates, as well as additional equity interests in other existing Affiliates.

### **Financing Cash Flow**

The increase in net cash flow from financing activities in 2004 from 2003 was attributable to our issuance of \$190.8 million of equity related to our 2001 PRIDES and greater borrowings under our Facility, and was partially offset by \$194.4 million of stock repurchases associated with the issuance of our 2004 PRIDES.

The increase in net cash flow from financing activities in 2003 from 2002 was attributable to our issuance of the floating rate senior convertible securities in February 2003. The principal sources of cash from financing activities during 2002 and 2003 were borrowings under our Facility and the issuances of convertible debt securities, respectively. In 2003, our uses of cash from financing activities were to repurchase \$116.5 million of principal amount at maturity of the zero coupon senior convertible securities, repurchase shares of our common stock and repay debt.

During 2004, we repurchased approximately 3.5 million shares of our common stock at an average price of \$55.73 per share under share repurchase programs authorized by our Board of Directors. A share repurchase program was authorized by the Board of Directors in April 2000, permitting us to repurchase up to 5% of our common stock. In July 2002 and April 2003, our Board of Directors approved increases to the existing share repurchase program, in each case authorizing the purchase of up to an additional 5% of our common stock. Our Board of Directors authorized an additional share repurchase program in connection with our 2004 PRIDES, permitting us to repurchase up to an additional 3.0 million shares of our outstanding common stock at the time of the closing of the 2004 PRIDES and an additional 1.5 million shares of common stock through February 2005. The timing and amount of purchases under the repurchase programs are determined at the discretion of our management. At March 8, 2005, approximately 2.0 million shares of common stock remained authorized for repurchase under the share repurchase programs.



## Contractual Obligations

The following table summarizes our contractual obligations as of December 31, 2004:

(dollars in millions)	Total	Payments Due			
		2005	2006-2007	2008-2009	Thereafter
Senior debt	\$ 134.4	\$ 4.1	\$ 130.3	\$ —	\$ —
Senior convertible debt	449.3	4.2	9.8	0.8	434.5
Mandatory convertible securities <sup>(1)</sup>	388.7	20.0	39.9	25.7	303.1
Purchases of Affiliate equity <sup>(2)</sup>	710.8	19.9	279.2	104.7	307.0
Leases	68.0	13.7	21.5	14.8	18.0
Other liabilities <sup>(3)</sup>	35.5	17.7	14.9	2.9	—
Total	\$ 1,786.7	\$ 79.6	\$ 495.6	\$ 148.9	\$ 1,062.6

(1) As more fully discussed on page 41, consistent with industry practice, we do not consider our mandatory convertible securities as debt for the purpose of determining our leverage ratio. Under the terms of our mandatory convertible securities, the exercise of the forward purchase contract component at the settlement date will result in the issuance of shares of our common stock and will generate cash proceeds to amortize debt in an amount equal to the remaining note portion of the securities.

(2) Purchases of Affiliate equity reflect estimates of our conditional purchases of additional equity in our Affiliates and assume that all conditions to such purchases are met and that such purchases will all be effected on the date that they are first exercisable. As described previously, these purchases may occur in varying amounts over the next 15 years (or longer), and the actual timing and amounts of such purchases (or the actual occurrence of such purchases) generally cannot be predicted with any certainty. Additionally, in many instances we have the discretion to settle these purchases with our common stock and in all cases can consent to the transfer of these interests to other individuals or entities. As one measure of the potential magnitude of such purchases, assuming that all such purchases had been effected as of December 31, 2004, the aggregate purchase amount would have totaled approximately \$710.8 million. Assuming the closing of such additional purchases, we would own the prospective cash flow distributions associated with all additional equity so purchased, estimated to be approximately \$100.3 million on an annualized basis as of December 31, 2004.

(3) Other liabilities reflect amounts payable to Affiliate managers related to our purchase of additional Affiliate equity interests.

## Interest Rate Sensitivity

Our revenue is 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.

We pay variable rates of interest on our floating rate senior convertible securities, and accordingly changing interest rates will affect the interest expense associated with these securities. We estimate that a 100 basis point (1%) increase in interest rates as of December 31, 2004 would result in a net increase in the interest expense related to our variable rate financings of approximately \$2.0 million. From time to time, we seek to offset such interest rate exposure by entering into hedging contracts.

We pay fixed rates of interest on the senior notes component of our 2004 PRIDES and our Senior Notes due 2006. While a change in market interest rates would not affect the interest expense incurred on these securities, such a change may affect the fair value of these securities. We estimate that a 100 basis point (1%) increase in interest rates as of December 31, 2004 would result in a net decrease in the fair value of our securities of approximately \$1.0 million at December 31, 2004.

## Market Risk

From time to time, we seek to offset our exposure to changing interest rates under our debt financing arrangements by entering into interest rate hedging contracts. As of December 31, 2004, we were a party, with three major commercial banks as counterparties, to \$150 million notional amount interest rate swap contracts which fix the interest rate on the notional amount to a weighted average interest rate of approximately 3.3% for the period from February 2005 to

February 2008. The unrealized loss on these interest rate swap contracts as of December 31, 2004 was \$0.4 million. We estimate that a 100 basis point (1%) increase in interest rates as of December 31, 2004 would result in a net increase in the unrealized value of approximately \$3.8 million. There can be no assurance that our hedging contracts will meet their overall objective of reducing our interest expense or that we will be successful in obtaining hedging contracts in the future on our existing or any new indebtedness.

### **Recent Accounting Developments**

Emerging Issues Task Force Issue No. 04-08 (“EITF 04-08”), “The Effect of Contingently Convertible Debt on Diluted Earnings per Share,” became effective in the fourth quarter of 2004. EITF 04-08 states that any shares of common stock that may be issued to settle contingently convertible securities (such as the shares that underlie our zero coupon senior convertible notes and floating rate senior convertible securities) must be considered issued in the calculation of diluted earnings per share, regardless of whether the market price trigger (or other contingent feature) in these securities has been met. This is commonly referred to as the “if-converted” method. EITF 04-08 requires the retroactive application to earnings per share measurements for all prior periods presented. The retroactive application of EITF 04-08 had the impact of reducing earnings per share by \$0.13, \$0.28 and \$0.42 in each of the years ending December 31, 2002, 2003 and 2004, respectively.

In December 2004, the Financial Accounting Standards Board (“FASB”) revised Statement of Financial Accounting Standards No. 123 (“FAS 123(R)”), requiring the measurement of the cost of all employee share-based payments (including stock option awards) in financial statements using a fair-value based method. We are required to adopt FAS 123(R) in the third quarter of fiscal 2005. Using a prospective application of the standard, compensation cost will be recognized on or after the effective date for the portion of all outstanding awards for which the required service has not yet been rendered. Compensation cost will be based on the

grant-date fair value of those awards. Although we continue to assess the impact of the adoption of FAS 123(R), we do not expect the adoption to have a material impact on our consolidated statements of operations or earnings per share.

In November 2004, the EITF reached a tentative conclusion on EITF Issue No. 04-5 (“EITF 04-5”), “Investor’s Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General Partner and the Limited Partners Have Certain Rights.” The tentative conclusion provides a framework for addressing whether a sole general partner should consolidate a limited partnership. The EITF acknowledged that the tentative conclusions reached in EITF 04-5 conflict with certain aspects of Statement of Position 78-9 – “Accounting for Investments in Real Estate Ventures” (“SOP 78-9”). The EITF requested that the FASB consider amending the guidance in SOP 78-9 to be consistent with the tentative conclusions reached in EITF 04-5. The FASB discussed this request at its meeting in November 2004, and agreed to propose an amendment to SOP 78-9 to address that inconsistency. Depending on the outcome of the discussions of the EITF in future meetings, the outcome could impact whether or not our Affiliates consolidate investment partnerships in which they hold a general partner interest.

### **Critical Accounting Estimates and Judgments**

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires us to make judgments, assumptions, and estimates that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Note 1 to the Consolidated Financial Statements describes the significant accounting policies and methods used in the preparation of the Consolidated Financial Statements. We consider the accounting policies described below to be our critical accounting estimates and judgments. These policies are affected significantly by judgments, assumptions, and estimates used in the preparation of the Consolidated Financial Statements and actual results could differ materially from the amounts reported based on these policies.

## Valuation

In allocating the purchase price of our investments and testing our intangible assets for impairment, we make estimates and assumptions to determine the value of our acquired client relationships and operating segments. We also assess the value of minority interests held by our Affiliate managers in establishing the terms for their transfer.

In these valuations, we make assumptions of the growth rates and useful lives of existing and prospective client accounts. Additionally, we make assumptions of, among other factors, valuation multiples, tax benefits and discount rates. In certain instances, we engage third party consultants to perform independent evaluations. The impact of many of these assumptions are material to our financial condition and operating performance and, at times, are subjective. If we used different assumptions, our intangible assets and related amortization could be stated differently and our impairment conclusions could be modified. Additionally, the use of different assumptions to value our minority interests could change the amount of compensation expense, if any, we report upon their transfer.

## Intangible Assets

At December 31, 2004, the carrying amounts of our intangible asset balances are as follows:

*(dollars in millions)*

Definite-lived acquired client relationships	\$ 195.3
Indefinite-lived acquired client relationships	245.1
Goodwill	888.6

These amounts exclude balances attributable to equity-method investments.

We amortize our definite-lived acquired client relationships over their expected useful lives. We reassess these lives each quarter based on historical attrition rates and other events and circumstances that may in the future influence these rates. Significant judgment is required to estimate the period that these assets will contribute to our cash flows and the

pattern over which these assets will be consumed. A change in the remaining useful life of any of these assets could have a significant impact on the amount of our amortization expense. For example, if we reduced the weighted average remaining life of our definite-lived acquired client relationships by one year, our amortization expense would increase by approximately \$1.9 million per year. We assess each of our definite-lived acquired client relationships for impairment at least annually by comparing their carrying value to their projected undiscounted cash flows. In the fourth quarter of 2004, we performed our most recent annual impairment test and no impairment was identified.

We do not amortize our indefinite-lived acquired client relationships because we expect these contracts will contribute to our cash flows indefinitely. Each quarter, we assess whether events and circumstances have occurred that indicate these relationships might have a definite life. We test the carrying amount of each of our indefinite-lived acquired client relationships at least annually, or at such time that we conclude the assets no longer have an indefinite life by comparing the carrying amount of each asset to its fair value. We derive the fair value of each of our indefinite-lived acquired client relationships primarily based on discounted cash flow analysis. Our valuation analysis reflects assumptions of the growth of the assets, discount rates and other factors. Changes in the estimates used in these valuations could materially affect the impairment conclusion. In the fourth quarter of 2004, we performed our most recent annual impairment test and no impairment was identified.

We test the carrying amount of the goodwill in each of our three operating segments at least annually by comparing their carrying amount to an estimate of fair value. We establish the fair value of each of our operating segments primarily based on price-earnings multiples. Changes in the estimates used in this test could materially affect our impairment conclusion. In the third quarter of 2004, we performed our most recent annual impairment test and no impairment was identified.



## Deferred Taxes

Our deferred tax liabilities are generated from tax-deductible intangible assets and, to a lesser extent, from our floating rate convertible securities. As more fully described below, we generally believe that our intangible-related deferred taxes (which totaled approximately \$26 million in 2004) are unlikely to reverse, and believe that the deferred tax liabilities for our floating rate convertible securities may not reverse. As such, we currently believe the economic benefit we realize from these sources will be permanent.

Our intangible assets are tax-deductible because we generally structure our Affiliate investments as cash transactions that are taxable to the sellers. We record deferred taxes because a substantial majority of our intangible assets do not amortize for financial statement purposes, but do amortize for tax purposes, thereby creating tax deductions that reduce our current cash taxes. These liabilities will reverse only in the event of a sale of an Affiliate or an impairment charge, events we consider unlikely to occur. Under current accounting rules, we are required to accrue the estimated cost of such a reversal as a deferred tax liability. As of December 31, 2004, our estimate of the tax liability associated with such a sale or impairment charge was approximately \$116 million.

Our floating rate convertible securities also generate deferred tax liabilities because our interest deductions for tax purposes are greater than our interest expense for financial statement purposes. As described in greater detail on page 43, if our stock price exceeds \$60.90 per share when the securities are converted, the cumulative tax savings realized in prior periods (\$8.7 million at December 31, 2004) will be reclassified to equity. As of December 31, 2004, our stock price was \$67.74. Beginning in February 2008, we have the right to redeem these securities, which could result in our realization of these benefits (which totaled approximately \$8.7 million as of December 31, 2004).

In addition, we also regularly assess our deferred tax assets, which consist primarily of state credits and loss carryforwards, in order to determine the need for valuation allowances. In our

assessment we make assumptions about future taxable income that may be generated to utilize these assets, which have limited lives. If we determine that we are unlikely to realize the benefit of a deferred tax asset, we would establish a valuation allowance that would increase our tax expense in the period of such determination. As of December 31, 2004, we had a valuation allowance for all state tax credit and loss carry forwards.

Changes in our tax position could have a material impact on our earnings. For example, a 1% increase to our statutory tax rate attributable to our deferred tax liabilities would result in an increase of approximately \$3.1 million in our tax expense in the period of such determination.

## Revenue Recognition

The majority of our consolidated revenue represents advisory fees (asset-based and performance-based). Our Affiliates recognize asset-based advisory fees quarterly as they render services to their clients. Unlike asset-based fees, which are calculated based upon a contractual percentage of a client's assets under management, performance-based fees are generally assessed as a percentage of the investment performance realized on a client's account, generally over an annual period. Our Affiliates recognize performance-based fees only when the fee becomes billable and not in quarters before then.

## Economic and Market Conditions

The asset management industry is an important segment of the financial services industry and has been a key driver of growth in financial services over the last decade. As of the end of 2003, according to the most recent available data, industry-wide assets under management across the Mutual Fund, Institutional and High Net Worth distribution channels totaled approximately \$23 trillion in the United States. We believe prospects for overall industry growth (estimated by a global securities firm to increase at a compound rate of 8% to 10% annually over the next five years) remain strong. We expect that this growth will be driven by market-related increases in assets under management, broad demographic trends and wealth creation related to

growth in gross domestic product, and will be experienced in varying degrees across all three of the principal distribution channels for our Affiliates' products: Mutual Fund, Institutional and High Net Worth.

In the Mutual Fund distribution channel, according to a 2004 industry report, more than 92 million individuals in almost 54 million households in the United States are invested in mutual funds. In 2004, net inflows to equity mutual funds totaled nearly \$180 billion, with aggregate mutual fund assets totaling \$8.1 trillion at the end of 2004. We anticipate that inflows to mutual funds will continue and that aggregate mutual fund assets, particularly those in equity mutual funds, will continue to increase in line with long-term market growth.

Assets in the Institutional distribution channel are in retirement plans, as well as endowments and foundations, with total assets in the channel of approximately \$7.5 trillion at the end of 2003. Net cash flows into Institutional products were approximately \$135 billion in 2004, with the majority of these new investments made in equity products. We anticipate that the combination of an aging work force and long-term market growth should contribute to the ongoing strength of this distribution channel.

The High Net Worth distribution channel is comprised broadly of high net worth and affluent individuals, family trusts and managed accounts. Within this channel, ultra high net worth and high net worth families and individuals (those having at least \$1 million in investable assets) had aggregate assets of \$7.8 trillion at the end of 2003; industry experts expect assets in this segment of the channel to grow to \$12.9 trillion by the end of 2008. We believe that affluent individuals (those having between \$250,000 and \$1 million in investable assets) represent an important source of asset growth within the High Net Worth channel, as the number of such individuals and the amount of investable assets increases, and the popularity of separately managed account investment products for affluent individuals continues to grow. According to a recent industry report, assets in

separately managed accounts totaled approximately \$575 billion at the end of 2004 (a nearly 16% increase over year end 2003) and are expected to reach \$1.3 trillion by 2008.

### **International Operations**

Genesis has offices in London, Guernsey and Chile. Tweedy, Browne Company LLC, which is based in New York, maintains a research office in London. DFD Select Group, S.A.R.L., a subsidiary of DFD Select Group Limited (in which we own a minority interest), is organized and headquartered in Paris, France and First Quadrant Limited, an affiliate of First Quadrant, L.P., is organized and headquartered outside of London, England. In the future, we may 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, less stringent legal, regulatory and accounting regimes, political instability, fluctuations in currency exchange rates, expatriation controls, expropriation risks 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 our affiliated investment management firms that have international operations or on other 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. See "Market Risk."

### **Quantitative and Qualitative Disclosures About Market Risk**

For quantitative and qualitative disclosures about how we are affected by market risk, see "Market Risk."

## Selected Historical Financial Data

Set forth below are selected financial data for the last five years. 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.

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	For the Years Ended December 31,				
(in thousands, except as indicated and per share data)	2000	2001	2002	2003	2004
<b>Statement of Operations Data</b>					
Revenue	\$ 458,708	\$ 408,210	\$ 482,536	\$ 495,029	\$ 659,997
Net Income <sup>(1)</sup>	56,656	49,989	55,942	60,528	77,147
Earnings per share – diluted <sup>(1)(2)</sup>	1.66	1.44	1.52	1.57	2.02
Average shares outstanding – diluted <sup>(2)</sup>	34,123	36,913	38,241	40,113	39,645
<b>Other Financial Data</b>					
Assets under Management (at period end, in millions)	\$ 77,523	\$ 81,006	\$ 70,809	\$ 91,524	\$ 129,802
Cash Flow from (used in):					
Operating activities	\$ 153,711	\$ 96,925	\$ 127,300	\$ 116,515	\$ 177,886
Investing activities	(111,730)	(343,674)	(138,917)	(73,882)	(478,266)
Financing activities	(63,961)	288,516	(34,152)	153,697	215,243
EBITDA <sup>(3)</sup>	142,378	132,143	138,831	147,215	186,434
Cash Net Income <sup>(4)</sup>	\$ 87,676	\$ 84,090	\$ 99,552	\$ 104,944	\$ 126,475
<b>Balance Sheet Data</b>					
Intangible assets <sup>(5)</sup>	\$ 643,470	\$ 974,956	\$ 1,113,064	\$ 1,116,036	\$ 1,328,976
Total assets <sup>(5)</sup>	793,730	1,160,321	1,242,994	1,519,205	1,933,421
Senior debt <sup>(6)</sup>	151,000	25,000	—	—	126,750
Senior convertible debt <sup>(7)</sup>	—	227,894	229,023	423,340	423,958
Mandatory convertible securities <sup>(8)</sup>	—	200,000	230,000	230,000	300,000
Other long-term obligations <sup>(9)</sup>	35,343	61,876	87,860	108,851	155,565
Stockholders' equity	493,910	543,340	571,861	614,769	707,692

- (1) Net Income and Earnings per share for the years ended December 31, 2000 and 2001 do not reflect changes in the accounting for intangible assets from the Company's implementation of FAS 142, "Goodwill and Other Intangible Assets," in 2002, and therefore are not directly comparable to the operating results of the other periods presented.
- (2) All average shares outstanding and earnings per share figures reflect the Company's three-for-two stock split in March 2004 and the effect of EITF Issue No. 04-08, "The Effect of Contingently Convertible Debt on Diluted Earnings per Share" ("EITF 04-08"). As further described in "Management's Discussion and Analysis," under EITF 04-08, the Company has included the shares of common stock that may be issued to settle its contingently convertible securities in the calculation of its diluted earnings per share for each of the periods presented, where applicable.
- (3) The definition of EBITDA is presented in Note 3 on page 35. Our use of EBITDA, including a reconciliation to cash flow from operations, is discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations."
- (4) Cash Net Income is defined as Net Income plus amortization and deferred taxes related to intangible assets plus Affiliate depreciation. We consider Cash Net Income an important measure of our financial performance, as we believe it best represents operating performance before non-cash expenses relating to the acquisition of interests in our affiliated investment management firms. Cash Net Income is not a measure of financial performance under generally accepted accounting principles and, as calculated by us, may not be consistent with computations of Cash Net Income by other companies. Our use of Cash Net Income, including a reconciliation of Cash Net Income to Net Income, is discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations." For periods prior to our adoption of FAS 142, we defined Cash Net Income as "Net Income plus depreciation and amortization." In connection with our adoption of FAS 142 in 2002, we modified our definition to be "Net Income plus depreciation, amortization and deferred taxes." In 2003, in connection with our issuance of convertible securities, we modified this definition to clarify that deferred taxes relating to these convertible securities and certain depreciation are not added back for the calculation of Cash Net Income. If we had used our current definition of Cash Net Income beginning in 2000, Cash Net Income for 2000, 2001 and 2002 would have been \$93.4 million, \$88.6 million and \$97.6 million, respectively.
- (5) Intangible and total assets have increased as we have made new or additional investments in affiliated investment management firms.
- (6) Senior debt includes outstanding borrowings under our senior revolving credit facility and, beginning in 2004, our Senior Notes due 2006.
- (7) Senior convertible debt consists of our zero coupon senior convertible notes, and beginning in 2003, our floating rate senior convertible securities.
- (8) Mandatory convertible securities consist of our 2001 PRIDES through 2003 and, beginning in 2004, our 2004 PRIDES.
- (9) Other long-term obligations consist principally of deferred income taxes, payables to related parties and the contract adjustment payment liability of our 2004 PRIDES.



## Management's Report on Internal Control Over Financial Reporting

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Management of Affiliated Managers Group, Inc., together with its consolidated affiliates (the Company), is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting processes are designed under the supervision of the Company's chief executive and chief financial officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States.

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States, and that receipts and expenditures are being made only in accordance with authorizations of management and the directors of the Company; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on our financial statements.

As of December 31, 2004, management conducted an assessment of the effectiveness of the Company's internal control over financial reporting based on the framework established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has determined that the Company's internal control over financial reporting as of December 31, 2004 was effective.

Management has excluded Genesis Fund Managers, LLP and TimesSquare Capital Management, LLC from our assessment of internal control over financial reporting as of December 31, 2004 because the Company acquired these affiliates in purchase business combinations during 2004. Genesis Fund Managers, LLP and TimesSquare Capital Management, LLC are consolidated affiliates whose total assets and total revenues represent 8% and 6%, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2004.

Management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2004 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report appearing on pages 53 and 54 of this Annual Report, which expresses unqualified opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting as of December 31, 2004.

## Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Affiliated  
Managers Group, Inc.:

We have completed an integrated audit of Affiliated Managers Group, Inc.'s 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2004 and audits of its 2003 and 2002 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

### Consolidated Financial Statements

In our opinion, the consolidated balance sheets and the related consolidated statements of operations, changes in stockholders' equity and cash flows present fairly, in all material respects, the financial position of Affiliated Managers Group, Inc. and its Affiliates (the Company) at December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. 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 the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements 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 our opinion.

As discussed in Note 1 to the consolidated financial statements, the Company adopted Emerging Issues Task Force Issue No. 04-8, "The Effect of Contingently Convertible Debt on Diluted Earnings per Share" effective December 31, 2004.

### Internal Control Over Financial Reporting

Also, in our opinion, management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting on page 52 of this Annual Report that the Company maintained effective internal control over financial reporting as of December 31, 2004 based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes

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obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As described in the accompanying Management's Report on Internal Control Over Financial Reporting, management has excluded Genesis Fund Managers, LLP and TimesSquare Capital Management, LLC from its assessment of internal control over financial reporting as of December 31, 2004 because they were acquired by the Company in purchase business combinations during 2004. We have also excluded Genesis Fund Managers, LLP and TimesSquare Capital Management, LLC from our audit of internal control over financial reporting. Genesis Fund Managers, LLP and TimesSquare Capital Management, LLC are consolidated subsidiaries of the Company whose total assets and total revenues represent 8% and 6%, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2004.

*Pranesh K. Gupta, CPA*

Boston, Massachusetts  
March 15, 2005



## Consolidated Balance Sheets

	December 31,		AMG
(in thousands)	2003	2004	55
<b>Assets</b>			
Current assets:			
Cash and cash equivalents	\$ 224,282	\$ 140,277	
Short-term investments	29,052	21,173	
Investment advisory fees receivable	65,288	91,487	
Prepaid expenses and other current assets	20,861	24,795	
Total current assets	339,483	277,732	
Fixed assets, net	36,886	40,953	
Equity investment in Affiliate	—	252,597	
Acquired client relationships, net	364,429	440,409	
Goodwill	751,607	888,567	
Other assets	26,800	33,163	
Total assets	\$ 1,519,205	\$ 1,933,421	
<b>Liabilities and Stockholders' Equity</b>			
Current liabilities:			
Accounts payable and accrued liabilities	\$ 89,707	\$ 114,350	
Payable to related party	11,744	17,728	
Total current liabilities	101,451	132,078	
Senior debt	—	126,750	
Senior convertible debt	423,340	423,958	
Mandatory convertible securities	230,000	300,000	
Deferred income taxes	92,707	124,168	
Other long-term liabilities	16,144	31,397	
Total liabilities	\$ 863,642	\$ 1,138,351	
Commitments and contingencies (Note 12)	—	—	
Minority interest	40,794	87,378	
Stockholders' equity:			
Common stock (\$.01 par value; 83,000 shares authorized; 35,277 shares outstanding in 2003 and 38,680 shares outstanding in 2004)	235	387	
Additional paid-in capital	408,449	566,776	
Accumulated other comprehensive income	944	1,537	
Retained earnings	306,972	384,119	
	716,600	952,819	
Less: treasury stock, at cost (3,270 shares in 2003 and 5,395 shares in 2004)	(101,831)	(245,127)	
Total stockholders' equity	614,769	707,692	
Total liabilities and stockholders' equity	\$ 1,519,205	\$ 1,933,421	

The accompanying notes are an integral part of the Consolidated Financial Statements.

## Consolidated Statements of Operations

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	For the Years Ended December 31,		
	2002	2003	2004
<i>(dollars in thousands, except per share data)</i>			
Revenue	\$ 482,536	\$ 495,029	\$ 659,997
Operating expenses:			
Compensation and related expenses	165,909	174,992	241,633
Selling, general and administrative	84,453	84,059	109,066
Amortization of intangible assets	14,529	16,176	18,339
Depreciation and other amortization	5,847	6,231	6,369
Other operating expenses	15,970	16,056	16,708
	286,708	297,514	392,115
Operating income	195,828	197,515	267,882
Non-operating (income) and expenses:			
Investment and other income	(3,473)	(8,245)	(8,460)
Interest expense	25,217	22,976	31,725
	21,744	14,731	23,265
Income before minority interest and income taxes	174,084	182,784	244,617
Minority interest	(80,846)	(80,952)	(115,524)
Income before income taxes	93,238	101,832	129,093
Income taxes – current	14,062	10,255	20,330
Income taxes – intangible-related deferred	22,835	23,899	25,791
Income taxes – other deferred	399	7,150	5,825
Net Income	\$ 55,942	\$ 60,528	\$ 77,147
Earnings per share – basic <sup>(1)</sup>	\$ 1.69	\$ 1.90	\$ 2.57
Earnings per share – diluted <sup>(1)</sup>	\$ 1.52	\$ 1.57	\$ 2.02
Average shares outstanding – basic <sup>(1)</sup>	33,029,223	31,867,989	29,994,560
Average shares outstanding – diluted <sup>(1)</sup>	38,240,591	40,113,040	39,644,676
Supplemental disclosure of total comprehensive income:			
Net Income	\$ 55,942	\$ 60,528	\$ 77,147
Other comprehensive income	602	1,188	593
Total comprehensive income	\$ 56,544	\$ 61,716	\$ 77,740

(1) Earnings per share and average shares outstanding reflect a three-for-two stock split that occurred in March 2004 and the Company's retroactive application of EITF 04-08 to each of the periods presented. See Note 16 for the calculation of Earnings per share – diluted.

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,			AMG 57
	2002	2003	2004	
Cash flow from operating activities:				
Net Income	\$ 55,942	\$ 60,528	\$ 77,147	
Adjustments to reconcile Net Income to cash flow from operating activities:				
Amortization of intangible assets	14,529	16,176	18,339	
Amortization of debt issuance costs	3,582	3,286	3,641	
Depreciation and amortization of fixed assets	5,847	6,231	6,369	
Deferred income tax provision	23,234	31,049	31,616	
Accretion of interest	1,129	713	1,155	
Tax benefit from exercise of stock options	1,446	3,039	8,027	
Other adjustments	(463)	(555)	1,228	
Changes in assets and liabilities:				
Decrease (increase) in investment advisory fees receivable	6,901	(14,490)	(26,199)	
Decrease (increase) in other current assets	(2,212)	(7,033)	1,827	
Decrease (increase) in non-current other receivables	(627)	663	(9,992)	
Increase in accounts payable, accrued expenses and other liabilities	22,569	6,612	16,386	
Increase (decrease) in minority interest	(4,577)	10,296	48,342	
Cash flow from operating activities	127,300	116,515	177,886	
Cash flow used in investing activities:				
Costs of investments in Affiliates, net of cash acquired	(136,499)	(19,052)	(474,104)	
Purchase of fixed assets	(6,151)	(23,889)	(6,977)	
Purchase of investments	—	(30,927)	(37,080)	
Sale of investments	—	—	39,955	
Increase in other assets	(213)	(14)	(60)	
Repayments of employee loans	3,946	—	—	
Cash flow used in investing activities	(138,917)	(73,882)	(478,266)	
Cash flow from (used in) financing activities:				
Borrowings of senior bank debt	290,000	85,000	134,000	
Repayments of senior bank debt	(315,000)	(85,000)	(83,000)	
Issuance of convertible securities	30,000	300,000	300,000	
Repurchase of convertible securities	—	(105,841)	(124,525)	
Issuance of common stock	3,453	11,375	210,232	
Repurchase of common stock	(30,432)	(33,688)	(194,420)	
Issuance costs	(5,060)	(7,850)	(12,800)	
Repayment of notes payable and other liabilities	(7,113)	(10,299)	(14,244)	
Cash flow from (used in) financing activities	(34,152)	153,697	215,243	
Effect of foreign exchange rate changes on cash flow	50	244	1,132	
Net increase (decrease) in cash and cash equivalents	(45,719)	196,574	(84,005)	
Cash and cash equivalents at beginning of period	73,427	27,708	224,282	
Cash and cash equivalents at end of period	\$ 27,708	\$ 224,282	\$ 140,277	
Supplemental disclosure of cash flow information:				
Interest paid	\$ 19,112	\$ 19,763	\$ 30,913	
Income taxes paid	10,080	9,918	12,240	
Supplemental disclosure of non-cash financing activities:				
Stock issued for Affiliate equity purchases	2,113	—	—	
Stock issued to settle 2001 PRIDES	—	—	28,499	
Payables recorded for Affiliate equity purchases	15,825	938	18,518	
Notes received for Affiliate equity sales	1,800	1,050	—	
Stock received for the exercise of stock options	—	200	206	
Stock received in repayment of loans	2,263	—	—	
Gain realized from settlement of forward purchase contracts	—	—	3,719	

The accompanying notes are an integral part of the Consolidated Financial Statements.

## Consolidated Statements of Changes in Stockholders' Equity

AMG

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<i>(dollars in thousands)</i>	Common Shares <sup>(1)</sup>	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Shares <sup>(1)</sup>	Treasury Shares at Cost
December 31, 2001	35,276,712	\$ 235	\$ 405,087	\$ 189,656	(1,963,262)	\$ (51,638)
Stock issued for option exercises	—	—	(114)	—	167,477	3,453
Tax benefit of option exercises	—	—	1,499	—	—	—
Issuance costs	—	—	(703)	—	—	—
Stock issued to purchase						
Affiliate equity	—	—	—	—	98,697	2,113
Stock received in repayment of loans	—	—	—	—	(109,698)	(3,839)
Repurchase of stock	—	—	—	—	(872,700)	(30,432)
Net Income	—	—	—	55,942	—	—
Other comprehensive income	—	—	—	602	—	—
December 31, 2002	35,276,712	\$ 235	\$ 405,769	\$ 246,200	(2,679,486)	\$ (80,343)
Stock issued for option exercises	—	—	(359)	—	510,620	11,735
Tax benefit of option exercises	—	—	3,039	—	—	—
Stock issued to settle notes payable	—	—	—	—	15,178	465
Repurchase of stock	—	—	—	—	(1,116,750)	(33,688)
Net Income	—	—	—	60,528	—	—
Other comprehensive income	—	—	—	1,188	—	—
December 31, 2003	35,276,712	\$ 235	\$ 408,449	\$ 307,916	(3,270,438)	\$ (101,831)
Stock issued for option exercises	—	—	(3,132)	—	714,516	22,521
Tax benefit of option exercises	—	—	8,027	—	—	—
Issuance costs	—	—	(9,263)	—	—	—
2004 PRIDES contract						
adjustment payment	—	—	(24,000)	—	—	—
Issuance of Affiliate equity interests	—	—	(7,519)	—	—	—
Stock split	—	118	(118)	—	—	—
Cash in lieu of fractional shares	—	—	(103)	—	—	—
Stock issued to settle 2001 PRIDES	3,403,742	34	194,435	—	647,704	28,499
Repurchase of stock	—	—	—	—	(3,486,512)	(194,316)
Net Income	—	—	—	77,147	—	—
Other comprehensive income	—	—	—	593	—	—
Balance at December 31, 2004	38,680,454	\$ 387	\$ 566,776	\$ 385,656	(5,394,730)	\$ (245,127)

(1) Common Shares and Treasury Shares reflect a three-for-two stock split that occurred in March 2004.

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

Affiliated Managers Group, Inc. (“AMG” or the “Company”) is an asset management company with equity investments in a diverse group of mid-sized investment management firms (“Affiliates”). AMG’s Affiliates provide investment management services, primarily in the United States, to mutual funds, institutional clients and high net worth individuals. Fees for services are largely asset-based and, as a result, the Company’s revenue may fluctuate based on the performance of financial markets.

In January 2005, the Company completed the formation of Managers Investment Group LLC (“Managers”), a distribution platform designed to expand its Affiliates’ product offerings and distribution capabilities by leveraging its product development, packaging, sales and support expertise. Managers operates as a single point of contact for retail intermediaries, offering more than 75 Affiliate products to mutual fund and separate account investors through banks, brokerage firms, insurance companies, and other sponsored platforms such as defined contribution plans. Managers has offices located throughout the United States, and is supported by a broad and experienced marketing and wholesaling team, which includes a significant external and internal sales force dedicated to providing sales and client services support.

Affiliates are either organized as limited partnerships, limited liability partnerships or limited liability companies. AMG has contractual arrangements with many of its Affiliates whereby a percentage of revenue is allocable to fund Affiliate operating expenses, including compensation (the “Operating Allocation”), while the remaining portion of revenue (the “Owners’ Allocation”) is allocable to AMG and the other partners or members, generally with a priority to AMG. In certain other cases, the Affiliate is not subject to a revenue sharing arrangement, but instead operates on a profit-based model. As a result, AMG participates fully in any

increase or decrease in the revenue or expenses of such firms. In situations where AMG holds a minority equity interest, the revenue sharing arrangement does not include an “Operating Allocation,” but instead AMG is allocated a percentage of the Affiliate’s revenue with the balance to be used to pay operating expenses and profit distributions to the other owners.

The financial statements are prepared in accordance with generally accepted accounting principles. All dollar amounts except per share data 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 to the current year’s presentation, including the classification of auction rate securities as available-for-sale securities, which are reported as short-term investments, instead of cash equivalents. These reclassifications had no impact on our results of operations or changes in stockholders’ equity.

### Cash and Cash Equivalents

The Company considers all highly liquid investments, including money market mutual funds, 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.

### Short-term Investments

Short-term investments consist of auction rate securities classified as available-for-sale, which are stated at estimated fair value. These investments are on deposit with two major financial institutions. Unrealized gains and losses, net of tax, are reported as a separate component of accumulated other comprehensive income in stockholders’ equity until realized. If the decline in fair value of these investments is determined to be other than temporary, the carrying amount of the asset is reduced to its fair value, and the difference is charged to income in the period incurred.

### Fixed Assets

Fixed assets are recorded at cost and depreciated using the straight-line method over their estimated useful lives.

The estimated useful lives of office equipment and furniture and fixtures range from three to ten years. Computer software developed or obtained for internal use is amortized using the straight-line method over the estimated useful life of the software, generally three years or less. Leasehold improvements are amortized over the shorter of their estimated useful lives or the term of the lease and the building is amortized over 39 years. The costs of improvements that extend the life of a fixed asset are capitalized, while the cost of repairs and maintenance are expensed as incurred. Land is not depreciated.

### Leases

The Company and its Affiliates currently lease office space and equipment under various leasing arrangements. As these leases expire, it can be expected that in the normal course of business they will be renewed or replaced. All leases and subleases are accounted for under Statement of Financial Accounting Standard ("SFAS") No. 13, "Accounting for Leases." These leases are classified as either capital leases, operating leases or subleases, as appropriate. Most lease agreements classified as operating leases contain renewal options, rent escalation clauses or other inducements provided by the landlord. Rent expense is accrued to recognize lease escalation provisions and inducements provided by the landlord, if any, on a straight-line basis over the lease term.

### Accounting for Investments in Affiliates

The method of accounting applied to investments in Affiliates, whether consolidated, equity or cost, involves an evaluation of the significant terms of each investment that explicitly grant or suggest evidence of control or influence over the operations of the investee. These Consolidated Financial Statements include the revenues and expenses of AMG and each Affiliate in which AMG has a majority equity interest. In each such instance, AMG is, directly or indirectly, the sole general partner (in the case of Affiliates which are limited partnerships), managing partner (in the case of Affiliates which are limited liability partnerships) or sole manager member (in the case of Affiliates which are

limited liability companies). For Affiliate operations consolidated into these financial statements, the portion of the income allocated to owners other than AMG is included in minority interest in the Consolidated Statements of Operations. Minority interest on the Consolidated Balance Sheets includes capital and undistributed income owned by the managers of the consolidated Affiliates. All material intercompany balances and transactions have been eliminated.

Investments where AMG or an Affiliate does not hold a majority equity interest but has the ability to exercise significant influence (generally at least a 20% interest or a general partner interest) over operating and financial matters are generally accounted for under the equity method of accounting. For these investments, AMG's or the Affiliate's portion of income is included in investment and other income. In other investments in which AMG or an Affiliate own less than a 20% interest and do not exercise significant influence are accounted for under the cost method. Under the cost method, income is recognized as dividends when, and if, declared.

The Company periodically evaluates its equity and cost method investments for impairment. In such impairment evaluations, the Company assesses if the value of the investment has declined below its book value for a period considered to be other than temporary. If the Company determines that a decline in value below the book value of the investment is other than temporary, then a charge is recognized in the Consolidated Statements of Operations.

The effect of any changes in the Company's Affiliate equity interests resulting from the issuance of equity by the Company or one of its Affiliates is included as a component of stockholders' equity, net of the related income tax effect in the period of the change.

### Acquired Client Relationships and Goodwill

The purchase price for the acquisition of interests in Affiliates is allocated based on the fair value of net assets

acquired, primarily acquired client relationships. In determining the allocation of the 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 Company has determined that certain of its mutual fund acquired client relationships meet the indefinite life criteria outlined in SFAS No. 142, "Goodwill and Other Intangible Assets" ("FAS 142"), because the Company expects both the renewal of these contracts and the cash flows generated by these assets to continue indefinitely. Accordingly, the Company does not amortize these intangible assets, but instead reviews these assets at least annually for impairment. Each reporting period, the Company assesses whether events or circumstances have occurred which indicate that the indefinite life criteria are no longer met. If the indefinite life criteria are no longer met, the Company assesses whether the carrying value of the assets exceeds its fair value, and an impairment loss is recorded in an amount equal to any such excess.

The cost assigned to all other acquired client relationships is amortized over a weighted average life of 13 years. The expected useful lives of acquired client relationships are analyzed each period 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 Company tests for the possible impairment of definite-lived intangible assets annually or more frequently whenever events or changes in circumstances indicate that the carrying amount of the asset is not recoverable.

If such indicators exist, the Company compares the undiscounted cash flows related to the asset to the carrying value of the asset. If the carrying value is greater than the undiscounted cash flow amount, an impairment charge is recorded in the statement of operations for amounts necessary to reduce the carrying value of the asset to fair value.

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 reported as goodwill within the operating segment in which the Affiliate operates. Goodwill is not amortized, but is instead reviewed annually for impairment. The Company assesses goodwill for impairment at least annually, or more frequently whenever events or circumstances occur indicating that the recorded goodwill may be impaired. Fair value is determined for each operating segment primarily based on price-earnings multiples. If the carrying amount of goodwill exceeds the fair value, an impairment loss is recorded in an amount equal to that excess.

As further described in Note 13, the Company periodically purchases additional equity interests in Affiliates from minority interest owners. Resulting payments made to such owners are generally considered purchase price for these acquired interests.

### Revenue Recognition

The Company's consolidated revenue represents advisory fees billed monthly, 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 as measured at the end of the contract period.

Also included in revenue are commissions earned by broker/dealers, recorded on a trade date basis, and other service fees recorded as earned.

### **Issuance Costs**

Issuance costs incurred in securing credit facility financing are amortized over the term of the credit facility. Costs incurred to issue the zero coupon senior convertible securities and floating rate senior convertible securities are amortized over the period to the first investor put date. Costs incurred to issue the Company's mandatory convertible securities are allocated between the senior notes and the purchase contracts based upon the relative cost to issue each instrument separately. Costs allocated to the senior notes are recognized as interest expense over the period of the forward purchase contract component of such securities. Costs allocated to the forward purchase contract are charged directly to additional paid-in capital and not amortized.

### **Derivative Financial Instruments**

The Company records all derivatives on the balance sheet at fair value. If the Company's derivatives qualify as cash flow hedges, the effective portion of the unrealized gain or loss is recorded in accumulated other comprehensive income as a separate component of stockholders' equity and reclassified into earnings when periodic settlement of variable rate liabilities are recorded in earnings. For interest rate swaps, hedge effectiveness is measured by comparing the present value of the cumulative change in the expected future variable cash flows of the hedged contract with the present value of the cumulative change in the expected future variable cash flows of the hedged item. To the extent that the critical terms of the hedged item and the derivative are not identical, hedge ineffectiveness would be reported in earnings as interest expense. Hedge ineffectiveness was not material in 2002, 2003 or 2004.

The Company is exposed to interest rate risk inherent in its variable rate debt liabilities. The Company's risk

management strategy may use financial instruments, specifically interest rate swap contracts, from time to time to hedge certain interest rate exposures. For example, the Company may agree with a counterparty (typically a major commercial bank) to exchange the difference between fixed-rate and floating-rate interest amounts calculated by reference to an agreed notional principal amount. In entering into these contracts, AMG intends to offset cash flow gains and losses that occur on its existing debt liabilities with cash flow gains and losses on the contracts hedging these liabilities.

### **Deferred Taxes**

Deferred taxes reflect the expected future tax consequences of temporary differences between the book carrying amounts and tax bases of the Company's assets and liabilities. Historically, deferred taxes have been comprised primarily of deferred tax liabilities attributable to intangible assets and deferred tax assets from state credits and loss carryforwards.

In measuring the amount of deferred taxes each period, the Company must project the impact on its future tax payments of any reversal of deferred tax liabilities (which would increase the Company's tax payments), and any use of its state credits and carryforwards (which would decrease its tax payments). In forming these estimates, the Company makes assumptions about future federal and state income tax rates and the apportionment of future taxable income to states in which the Company has operations. An increase or decrease in federal or state income tax rates could have a material impact on the Company's deferred income tax liabilities and assets and would result in a current income tax charge or benefit.

In the case of the Company's deferred tax assets, the Company regularly assesses the need for valuation allowances, which would reduce these assets to their recoverable amounts. In forming these estimates, the Company makes assumptions of future taxable income that may be generated to utilize these assets, which have



limited lives. If the Company determines that these assets will be realized, the Company records an adjustment to the valuation allowance, which would decrease tax expense in the period such determination was made. Likewise, should the Company determine that it would be unable to realize additional amounts of deferred tax assets, an adjustment to the valuation allowance would be charged to tax expense in the period such determination was made. For example, if the Company was to make an investment in a new Affiliate located in a state where it has operating loss carryforwards, the projected taxable income from the new Affiliate could be offset by these operating loss carryforwards, justifying a reduction to the valuation allowance.

### 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. Revenue and expenses are translated at the average monthly exchange rates then in effect.

### Equity-Based Compensation Plans

SFAS No. 123, "Accounting for Stock-Based Compensation" ("FAS 123"), as amended by SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure" ("FAS 148"), encourages but does not require adoption of a fair value method for equity-based compensation arrangements. 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 method had been applied in measuring compensation cost.

The Company continues to apply the intrinsic value method prescribed by APB 25 in accounting for its stock-based compensation plans. Under this method, compensation cost is measured at the grant date based on the intrinsic value of the award and is recognized over the vesting period. Had compensation cost for the Company's stock option plans been determined based on the fair value

method set forth in FAS 123, Net Income and earnings per share would have been as follows:

	Year Ended December 31,		
	2002	2003	2004
Net Income –			
as reported	\$ 55,942	\$ 60,528	\$ 77,147
Less: Stock-based compensation expense determined under fair value method, net of tax	9,763	10,614	14,326
Less: Stock-based compensation expense determined under fair value method, related to 2003 Amendment, net of tax	—	22,054	—
Net Income – FAS 123 pro forma	\$ 46,179	\$ 27,860	\$ 62,821
Earnings per share – basic – as reported	\$ 1.69	\$ 1.90	\$ 2.57
Earnings per share – basic – FAS 123 pro forma	1.40	0.87	2.09
Earnings per share – diluted – as reported	1.52	1.57	2.02
Earnings per share – diluted – FAS 123 pro forma	1.26	0.75	1.66

In 2003, the Board of Directors approved an amendment (the "2003 Amendment") to certain of the Company's stock option agreements that resulted in unvested options becoming vested options to purchase shares of restricted stock. The 2003 Amendment was approved in conjunction with a change in the Company's overall compensation strategy which is now increasingly dependent upon the use of restricted stock as a primary equity incentive. The shares issuable upon the exercise of the accelerated options remain the property of the holder under any circumstances, subject to restrictions on transfer. The transfer restrictions lapse according to specified schedules, generally over four years from the date of grant for so long as the option holder remains employed by the Company. In the event the option

holder ceases to be employed, the transferability restrictions will remain outstanding until December 2010. As a result of the amendment, no compensation expense was recorded under APB 25 in the Company's consolidated statement of operations. The Company may realize a charge under APB 25 in future periods if options are exercised that would have otherwise been forfeited (prior to the 2003 Amendment).

The weighted average fair value of options granted in the years ended December 31, 2002, 2003 and 2004 were estimated at \$7.02, \$10.13, and \$12.77 per option, respectively, using the Black-Scholes option pricing model. The following weighted average assumptions were used for the option valuations.

	Year Ended December 31,		
	2002	2003	2004
Dividend yield	0.0%	0.0%	0.0%
Expected volatility	27.5%	24.9%	20.4%
Risk-free interest rate	3.4%	2.7%	3.3%
Expected life of options (in years)	4.6	4.6	4.4

### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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

Emerging Issues Task Force ("EITF") Issue No. 04-08 ("EITF 04-08"), "The Effect of Contingently Convertible Debt on Diluted Earnings per Share" became effective in the fourth quarter of 2004. EITF 04-08 states that any shares of common stock that may be issued to settle contingently convertible securities (such as the shares that underlie the Company's zero coupon senior convertible notes and floating rate senior convertible securities) must be considered issued in the calculation of diluted earnings per share, regardless of

whether the market price trigger (or other contingent feature) in these securities has been met. This is commonly referred to as the "if-converted" method. EITF 04-08 requires the retroactive application to earnings per share measurements for all prior periods presented. The retroactive application of EITF 04-08 had the impact of reducing earnings per share by \$0.13, \$0.28 and \$0.42 in each of the years ending December 31, 2002, 2003 and 2004, respectively.

In December 2004, the Financial Accounting Standards Board ("FASB") revised FAS 123 ("FAS 123(R)"), requiring the measurement of the cost of all employee share-based payments to employees, including stock option awards, in financial statements using a fair-value based method. The Company is required to adopt FAS 123(R) in the third quarter of fiscal 2005. Using a prospective application of the standard, compensation cost will be recognized on or after the effective date for the portion of all outstanding awards for which the required service has not yet been rendered. Compensation cost will be based on the grant-date fair value of those awards. Although the Company continues to assess the impact of the adoption of FAS 123(R), it does not expect the adoption to have a material impact on its consolidated statements of operations or earnings per share.

In November 2004, the Emerging Issues Task Force reached a tentative conclusion on EITF Issue No. 04-5 ("EITF 04-5"), "Investor's Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General Partner and the Limited Partners Have Certain Rights." The tentative conclusion provides a framework for addressing the question of when a sole general partner, as defined in EITF 04-5, should consolidate a limited partnership. The EITF acknowledged that the tentative conclusions reached in Issue 04-5 conflict with certain aspects of Statement of Position 78-9—Accounting for Investments in Real Estate Ventures ("SOP 78-9"). The EITF requested that the FASB consider amending the guidance in SOP 78-9 to be consistent with the tentative conclusions reached in EITF 04-5. The FASB discussed this request at its meeting in November 2004, and agreed to propose an amendment to SOP 78-9 to address that inconsistency.

Depending on the outcome of the discussions of the EITF in future meetings, the outcome could impact whether or not the Company's Affiliates consolidate investment partnerships in which they hold a general partner interest.

## 2. Concentrations of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash investments. The Company maintains cash and cash equivalents, short-term investments and, at times, certain financial instruments with various financial institutions. These financial institutions are typically located in cities in which AMG and its Affiliates operate. For AMG and certain Affiliates, cash deposits at a financial institution may exceed Federal Deposit Insurance Corporation insurance limits.

## 3. Stock Split

In March 2004, the Company completed a three-for-two stock split, effected in the form of a stock dividend. Corresponding with this split, the conversion and settlement rates of outstanding convertible securities and the number of shares of common stock subject to outstanding options were appropriately adjusted. As applicable, the information provided in these notes to financial statements reflects the stock split.

## 4. Fixed Assets and Lease Commitments

Fixed assets consist of the following:

	At December 31,	
	2003	2004
Building and leasehold improvements	\$ 21,905	\$ 22,954
Office equipment	14,960	15,521
Furniture and fixtures	12,059	12,924
Land and improvements	12,024	12,137
Computer software	4,986	5,265
Fixed assets, at cost	65,934	68,801
Accumulated depreciation and amortization	(29,048)	(27,848)
Fixed assets, net	\$ 36,886	\$ 40,953

The Company and its Affiliates lease office space and computer equipment for their operations. At December 31, 2004, the Company's aggregate future minimum payments for operating leases having initial or noncancelable lease terms greater than one year are payable as follows:

Year Ending December 31,	Required Minimum Payments
2005	\$ 13,749
2006	11,603
2007	9,931
2008	7,934
2009	6,896
Thereafter	18,038

Consolidated rent expense for 2002, 2003 and 2004 was \$15,970, \$16,056 and \$16,708, respectively.

## 5. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consisted of the following:

	At December 31,	
	2003	2004
Accrued compensation	\$ 54,501	\$ 57,992
Accrued income taxes	10,410	16,648
Accounts payable	3,528	8,199
Contract adjustment payments	—	7,137
Accrued professional services	3,606	6,832
Accrued interest	2,027	2,836
Deferred revenue	1,309	1,012
Other	14,326	13,694
	\$ 89,707	\$114,350

## 6. Benefit Plans

The Company has two defined contribution plans consisting of a qualified employee profit-sharing plan covering substantially all of its full-time employees and five of its Affiliates, and a non-qualified plan for certain senior employees. Fourteen of AMG's other Affiliates have separate defined contribution retirement plans. Under each of the qualified plans, AMG and each participating Affiliate, as the case may be, are able to make discretionary contributions

for the benefit of qualified plan participants up to IRS limits. Consolidated expenses related to the Company's qualified and non-qualified plans in 2002, 2003 and 2004 were \$7,325, \$7,421 and \$9,055, respectively.

## 7. Senior Debt

The components of senior debt are as follows:

	At December 31,	
	2003	2004
Senior revolving credit facility	\$ —	\$ 51,000
Senior notes due 2006	—	75,750
Zero coupon senior convertible notes	123,340	123,958
Floating rate senior convertible securities	300,000	300,000
Total	\$423,340	\$550,708

### Senior Revolving Credit Facility

In August 2004, we amended our senior revolving credit facility with a syndicate of major commercial banks, which previously allowed for borrowings of up to \$250,000. The amended credit facility (the "Facility") extends the maturity date to August 2007 and currently provides that the Company may borrow up to \$405,000 at rates of interest (based either on the Eurodollar rate or the prime rate as in effect from time to time) that vary depending on the Company's credit ratings. Subject to the agreement of the lenders (or prospective lenders) to increase their commitments, the Company has the option to increase the Facility up to \$450,000. The Facility contains financial covenants with respect to net worth, leverage and interest coverage. The Facility also contains customary affirmative and negative covenants, including limitations on indebtedness, liens, cash dividends and fundamental corporate changes. Any borrowings under the Facility would be collateralized by pledges of all capital stock or other equity interests owned by the Company. The Company pays a quarterly commitment fee on the daily unused portion of the Facility, which fee amounted to \$705, \$619 and \$717 for the years ended December 31, 2002, 2003 and 2004, respectively.

### Senior Notes due 2006

In December 2001, the Company completed a public offering of mandatory convertible securities ("2001 PRIDES"). A sale of an over-allotment of the securities was completed in January 2002, increasing the aggregate amount outstanding to \$230,000. Each unit of the 2001 PRIDES initially consisted of (i) a senior note due November 17, 2006 with a principal amount of \$25 per note, on which the Company pays quarterly interest, and (ii) a forward purchase contract pursuant to which the holder has agreed to purchase shares of the Company's common stock on November 17, 2004, with the number of shares to be determined based upon the average trading price of the Company's common stock for a period preceding that date.

In August 2004, the Company repurchased \$154,250 in aggregate principal amount of the senior notes component of the 2001 PRIDES. The Company repurchased the notes through a tender offer, a privately negotiated purchase and certain repurchases in the August 2004 remarketing of the notes. The Company reported a loss of \$2,493 on the purchase of these notes, which was reported in "Investment and other income." Following these transactions, \$75,750 in aggregate principal amount of the notes component of the 2001 PRIDES remains outstanding, with an interest rate of approximately 5.41% and a maturity date of November 2006.

### Zero Coupon Senior Convertible Notes

In May 2001, the Company completed a private placement of zero coupon senior convertible notes. In this private placement, the Company sold an aggregate of \$251,000 principal amount at maturity of zero coupon senior convertible notes due 2021, with each note issued at 90.50% of such principal amount and accreting at a rate of 0.50% per year. Each security is convertible into 17.429 shares of the Company's common stock upon the occurrence of certain events, including the following: (i) if the closing price of a share of the Company's common stock is more than a specified price over certain periods (initially \$62.36 and increasing incrementally at the end of each calendar



quarter to \$63.08 on April 1, 2021); (ii) if the credit rating assigned by Standard & Poor's to the securities is below BB-; or (iii) if the Company calls the securities for redemption. The holders may require the Company to repurchase the securities at their accreted value on May 7 of 2006, 2011 and 2016. If the holders exercise this option in the future, the Company may elect to repurchase the securities with cash, shares of its common stock or some combination thereof. The Company has the option to redeem the securities for cash on or after May 7, 2006 at their accreted value. In 2003, the Company repurchased an aggregate \$116,500 principal amount at maturity of zero coupon senior convertible notes in privately negotiated transactions and realized a gain of \$555, which was reported in "Investment and other income." Under the terms of the indenture governing the zero coupon senior convertible notes, through March 31, 2005 a holder may convert such security into common stock of the Company by following the procedures for conversion set forth in the indenture.

#### **Floating Rate Senior Convertible Securities**

In February 2003, the Company completed a private placement of \$300,000 of floating rate senior convertible securities due 2033 ("convertible securities"). The convertible securities bear interest at a rate equal to three-month LIBOR minus 0.50%, payable in cash quarterly. Each security is convertible into shares of the Company's common stock upon the occurrence of certain events, including the following: (i) if the closing price of a share of the Company's common stock exceeds \$65.00 over certain periods; (ii) if the credit rating assigned by Standard & Poor's is below BB-; or (iii) if the Company calls the securities for redemption. Upon conversion, holders of the securities will receive 18.462 shares of the Company's common stock for each convertible security. In addition, if the market price of the Company's common stock exceeds \$54.17 per share at the time of conversion, holders will receive additional shares of common stock based on the stock price at that time. Based on the trading price of the Company's common stock as of December 31, 2004, upon conversion, a holder of the securities would receive an additional 2.254

shares. The holders of the convertible securities may require the Company to repurchase such securities on February 25 of 2008, 2013, 2018, 2023 and 2028, at their principal amount. The Company may choose to pay the purchase price for such repurchases with cash, shares of its common stock or some combination thereof. The Company may redeem the convertible securities for cash at any time on or after February 25, 2008, at their principal amount.

As further described in Note 10, the Company has entered into interest rate swap agreements of a notional amount of \$150,000. For the period February 2005 through February 2008, the Company will pay a weighted average fixed rate of approximately 3.28% on that amount.

#### **8. Mandatory Convertible Securities**

The components of the Company's mandatory convertible securities are as follows:

	At December 31,	
	2003	2004
2001 mandatory convertible securities	\$230,000	\$ —
2004 mandatory convertible securities	—	300,000
Total	\$230,000	\$300,000

#### **2001 Mandatory Convertible Securities**

As described in Note 7, the Company had \$230,000 of the 2001 PRIDES outstanding at December 31, 2003. In August 2004, the Company settled \$39,250 of the 2001 PRIDES forward purchase contracts and realized a gain of \$3,719, which was recorded directly to stockholders' equity. In November 2004, the Company received \$190,750 in gross proceeds upon settlement of the remaining forward purchase contracts associated with the 2001 PRIDES and issued 3.4 million shares. In connection with the issuance of the 2004 PRIDES (as described below), the Company repurchased an aggregate of approximately 3.5 million shares of its common stock during the nine months ended September 30, 2004. The share repurchases were intended

to offset the Company's obligation to issue shares of its common stock in November 2004 under the terms of the forward purchase contracts component of the 2001 PRIDES.

### 2004 Mandatory Convertible Securities

In February 2004, the Company completed a private placement of \$300,000 of mandatory convertible securities ("2004 PRIDES"). As described below, these securities are also structured to provide \$300,000 of additional proceeds to the Company following a successful remarketing and the exercise of forward purchase contracts in February 2008.

Each unit of the 2004 PRIDES initially consists of (i) a senior note due February 17, 2010 with a principal amount of \$1,000 per note, on which the Company pays interest quarterly at the annual rate of 4.125%, and (ii) a forward purchase contract pursuant to which the holder has agreed to purchase shares of the Company's common stock on February 17, 2008. The proceeds from this offering were allocated to mandatory convertible securities and stockholders' equity based on their relative fair values. Holders of the purchase contracts receive a quarterly contract adjustment payment at the annual rate of 2.525% per \$1,000 purchase contract. The present value of the future contract adjustment payments (\$24,000) was recorded as a charge to paid-in capital at inception. As of December 31, 2004, the current and long-term portions of the contract adjustment payments, approximately \$7,137 and \$11,700, respectively, have been recorded in current liabilities and other long-term liabilities, respectively. The number of shares to be issued on February 17, 2008 will be determined based upon the average trading price of the Company's common stock for a period preceding that date. Depending on the average trading price in that period, the settlement rate will range from 11.785 to 18.031 shares per \$1,000 purchase contract. Based on the trading price of the Company's common stock as of December 31, 2004, the purchase contracts would have a settlement rate of 14.762.

Each of the senior notes is pledged to the Company to collateralize the holder's obligations under the forward

purchase contracts. Beginning in August 2007, under the terms of the 2004 PRIDES, the senior notes are expected to be remarketed to new investors. A successful remarketing will generate \$300,000 of gross proceeds to be used by the original holders of the 2004 PRIDES to honor their obligations on the forward purchase contracts. In exchange for the additional \$300,000 in payment on the forward purchase contracts, the Company will issue shares of its common stock to the original holders of the senior notes. As referenced above, the number of shares of common stock to be issued will be determined by the market price of the Company's common stock at that time. Assuming a successful remarketing, the senior notes will remain outstanding until at least February 2010.

## 9. Income Taxes

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

		Year Ended December 31,		
		2002	2003	2004
Federal:	Current	\$ 12,916	\$ 8,975	\$ 17,791
	Deferred	20,331	27,167	28,283
State:	Current	1,146	1,280	2,539
	Deferred	2,903	3,882	3,333
Provision for income taxes		\$ 37,296	\$ 41,304	\$ 51,946

The Company's effective income tax rate differs from the amount computed by using income before income taxes and applying the U.S. federal income tax rate to such amount because of the effect of the following items:

		Year Ended December 31,		
		2002	2003	2004
Tax at U.S. federal income tax rate		34.8%	35.0%	35.0%
Nondeductible expenses		1.0	1.7	0.7
State income taxes, net of federal benefit		2.0	2.2	1.6
Valuation allowance		2.2	1.7	2.9
		40.0%	40.6%	40.2%

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

	December 31,	
	2003	2004
Deferred assets (liabilities):		
State net operating loss and credit carryforwards	\$ 7,696	\$ 10,362
Intangible asset amortization	(90,626)	(116,417)
Deferred compensation	452	320
Convertible securities interest	(5,097)	(8,704)
Accruals	1,483	608
	(86,092)	(113,831)
Valuation allowance	(6,615)	(10,337)
Net deferred income taxes	\$ (92,707)	\$ (124,168)

Deferred tax liabilities are primarily the result of tax deductions for the Company's intangible assets and convertible securities. The Company amortizes its goodwill and certain other intangible assets for tax purposes only, reducing its tax basis below their carrying value for financial statement purposes. The Company's floating rate senior convertible securities currently generate tax deductions that are higher than the interest expense recorded for financial statement purposes.

At December 31, 2004, the Company had state net operating loss carryforwards that will expire over a 15-year period beginning in 2005. The Company also has state tax credit carryforwards which will expire over a 10-year period beginning in 2005. The valuation allowance at December 31, 2003 and 2004 is related to the uncertainty of the realization of most of these loss and credit carryforwards, which realization depends upon the Company's generation of sufficient taxable income prior to their expiration. The change in the valuation allowance for the year ended December 31, 2004 is attributable to state net operating losses during this period and a provision for loss carryforwards that the Company no longer believes will be realized.

## 10. Derivative Financial Instruments

The Company periodically uses interest rate derivative contracts to manage market exposures associated with its variable

interest rate debt by creating offsetting fixed rate market exposures. In May 2004, the Company entered into a \$50,000 notional amount interest rate swap agreement, which became effective February 2005. The Company also entered into similarly-structured agreements of \$50,000 in each of September and October 2004. These swap contracts were entered into with major commercial banks as counterparties to exchange the difference between floating rate and fixed rate interest amounts calculated by reference to the notional amount.

The Company records all derivatives on the balance sheet at fair value. As cash flow hedges, the effective portion of the unrealized gain or loss on the derivative instruments is recorded in accumulated other comprehensive income as a separate component of stockholders' equity. At December 31, 2003, the Company did not have any net unrealized losses on derivative instruments. At December 31, 2004, the unrealized loss (before taxes) on the derivative instruments was \$387.

## 11. Comprehensive Income

A summary of comprehensive income, net of applicable taxes, is as follows:

	For the year ended December 31,		
	2002	2003	2004
Net Income	\$ 55,942	\$ 60,528	\$ 77,147
Change in unrealized foreign currency gains	50	244	1,132
Change in net unrealized gains (losses) on derivative instruments	405	—	(232)
Reclassification of FAS 133 transition adjustment to Net Income	147	—	—
Change in unrealized gain on investment securities	—	944	11
Reclassification of unrealized gain on investment securities to realized gain	—	—	(318)
Comprehensive income	\$ 56,544	\$ 61,716	\$ 77,740

The components of accumulated other comprehensive income, net of applicable taxes, were as follows:

	December 31,	
	2003	2004
Foreign currency translation adjustment	\$ —	\$ 1,132
Unrealized gain on investment securities	944	637
Unrealized loss on derivative instruments	—	(232)
Accumulated other comprehensive income	\$ 944	\$ 1,537

## 12. Commitments and 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 in a manner unfavorable to the Company or its Affiliates. The Company and its Affiliates establish accruals for matters for which the outcome is 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.

Federal and state regulators have ongoing investigations of the mutual fund industry as a whole focused on a number of issues, including late trading and market timing, and have sent requests for information to a number of mutual fund companies, broker/dealers and mutual fund distributors, including Affiliates of the Company. The Company believes there will be no material adverse effect as a result of these matters on the financial condition of the Company.

Certain Affiliates operate under regulatory authorities which require they maintain minimum financial or capital requirements. Management is not aware of any violations of such financial requirements occurring during the year.

## 13. Acquisitions

The Company's Affiliate investments in the year ended December 31, 2002, 2003 and 2004 totaled \$152,324, \$20,645 and \$508,781, respectively. In 2004 the Company completed investments in Genesis Fund Managers, LLP ("Genesis"), TimesSquare Capital Management, LLC ("TimesSquare"), AQR Capital Management, LLC ("AQR"), and certain other existing Affiliates, including Friess Associates, LLC ("Friess"). These investments were made pursuant to the Company's growth strategy designed to generate shareholder value by making investments in mid-sized investment management firms and other strategic transactions designed to expand the Company's participation in its three principal distribution channels.

The Company acquired a 60% interest in Genesis in June 2004. With offices in London, Guernsey and Chile, Genesis manages approximately \$10.8 billion in emerging markets equity investment products, primarily for institutional clients in the United States, United Kingdom, Europe and Australia. Genesis' management team holds the remaining 40% interest. The transaction was financed through the Company's available cash.

The Company purchased an additional 19% interest in its Affiliate, Friess, in November 2004. Friess is the advisor to the Brandywine family of no-load mutual funds and also advises separate portfolios for charitable foundations, major corporations and high net worth individuals. AMG now holds a 70% interest in Friess. The remaining equity ownership of the firm continues to be held by a broad group of Friess professionals. The transaction closed pursuant to the terms of the Company's original investment in Friess in October 2001. The transaction was financed through the Company's available cash.

The Company acquired a 60% interest in the growth equity business of TimesSquare in November 2004. TimesSquare manages approximately \$5.5 billion in growth-oriented small and mid-cap investment products on behalf of approximately 90 institutional clients, including public and corporate



pension funds, endowments and foundations, and Taft-Hartley retirement plans. TimesSquare's management team holds the remaining 40% interest. The transaction was financed through the Company's available cash.

The Company acquired a minority equity interest in AQR in November 2004. AQR is a leading quantitative investment management firm and hedge fund manager, with approximately \$13.0 billion in assets under management, over \$6.9 billion of which is in hedge fund products. Based in Greenwich, Connecticut, AQR offers quantitatively managed hedge funds and long-only international equity products provided through collective investment vehicles and separate accounts for more than 500 institutional and high net worth clients. This transaction is accounted for under the equity method of accounting. In 2004, the Company's portion of income, net of intangible amortization, was approximately \$1,266. This amount is included in "Investment and other income" within the Company's Institutional channel. The transaction was financed through the Company's available cash and borrowings under its senior revolving credit facility.

In addition to the investments described above, during 2004 the Company also acquired interests in existing Affiliates, which were financed through working capital and the issuance of notes.

In the year ended December 31, 2003, the Company completed investments in certain existing Affiliates, which were financed through working capital and the issuance of notes.

In the year ended December 31, 2002, the Company completed investments in Third Avenue Management LLC ("Third Avenue") and certain other existing Affiliates. The Company acquired 60% of New York-based Third Avenue in August 2002. Third Avenue serves as the advisor to the Third Avenue family of no-load mutual funds and the sub-advisor to non-proprietary mutual funds and annuities, and also manages separate accounts for high net worth individuals and institutions. The transaction was financed through the Company's working capital and borrowings under the Company's senior

revolving credit facility. During 2002, the Company also made payments to acquire interests in existing Affiliates, which were financed through working capital and the issuance of notes and shares of the Company's common stock.

The assets and liabilities of the investments in acquired businesses are accounted for under the purchase method of accounting and recorded at their fair values at the dates of acquisition. The excess of the purchase price over the estimated fair values of the net assets acquired is recorded as an increase in goodwill. The results of operations of acquired businesses have been included in the Consolidated Financial Statements beginning as of the date of acquisition. The following table summarizes the net assets acquired during the year ended December 31, 2004:

<i>(dollars in thousands)</i>	
Current assets, net	\$ 6,398
Fixed assets	3,459
Definite-lived acquired	
client relationships	46,591
Indefinite-lived acquired	
client relationships	47,728
Goodwill	136,960
Net assets acquired	<u>\$ 241,136</u>

In connection with the Company's investment in AQR in 2004 and in accordance with the equity method of accounting, approximately \$85.0 million of acquired client relationships and \$165.0 million of goodwill have been classified within Equity Investment in Affiliate. The Company's purchase price allocation for this investment is subject to the finalization of the valuation of acquired client relationships. As a result, these preliminary amounts may be subject to revision in future periods.

Unaudited pro forma financial results are set forth below, giving consideration to the investments in Third Avenue, Genesis, TimesSquare, AQR and Friess as if such transactions occurred as of the beginning of 2003, assuming revenue sharing arrangements had been in effect for the entire period and after making certain other pro forma adjustments.

	Year Ended December 31,	
	2003	2004
Revenue	\$ 556,470	\$ 712,641
Net Income	75,192	96,595
Earnings per share – basic	\$ 2.36	\$ 3.22
Earnings per share – diluted	\$ 2.00	\$ 2.57

In conjunction with certain acquisitions, the Company has entered into agreements and is contingently liable, upon achievement of specified financial targets, to make additional purchase payments of up to \$169,000. If required, these contingent payments will be settled for cash beginning in 2005 and will be accounted for as an adjustment to the purchase price of the Affiliate.

The Company's operating agreements provide Affiliate managers a conditional right to require AMG to purchase their retained equity interests at certain intervals. Certain agreements also provide AMG a conditional right to require Affiliate managers to sell their retained equity interests to us at certain intervals and upon their death, permanent incapacity or termination of employment and provide Affiliate managers a conditional right to require the Company to purchase such retained equity interests upon the occurrence of specified events. The purchase price of these conditional

purchases are generally calculated based upon a multiple of the Affiliate's cash flow distributions, which is intended to represent fair value. As one measure of the potential magnitude of such purchases, in the event that a triggering event and resulting purchase occurred with respect to all such retained equity interests as of December 31, 2004, the aggregate amount of these payments would have totaled approximately \$710,815. In the event that all such transactions were closed, AMG would own the prospective cash flow distributions of all equity interests that would be purchased from the Affiliate managers. As of December 31, 2004, this amount would represent approximately \$100,300 on an annualized basis.

#### 14. Goodwill and Acquired Client Relationships

As described in Note 13, in 2004 the Company completed its investments in Genesis and TimesSquare, acquired additional interests in existing Affiliates and transferred certain interests to Affiliate management. All goodwill acquired during this period is deductible for tax purposes. The increase in goodwill associated with transactions with majority-owned investments, net of the cost of transferred interests, as well as the carrying amounts of goodwill, are reflected in the following table for each of the Company's operating segments, which are discussed in greater detail in Note 20:

	Mutual Fund	Institutional	High Net Worth	Total
Balance, as of December 31, 2002	\$ 268,534	\$ 289,312	\$ 181,207	\$ 739,053
Goodwill acquired	4,383	6,700	1,471	12,554
Balance, as of December 31, 2003	272,917	296,012	182,678	751,607
Goodwill acquired	26,372	102,272	8,316	136,960
Balance, as of December 31, 2004	\$ 299,289	\$ 398,284	\$ 190,994	\$ 888,567

The following table reflects the components of intangible assets of majority-owned investments as of December 31, 2003 and 2004:

	2003		2004	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Acquired client relationships	\$ 233,004	\$ 65,898	\$ 279,595	\$ 84,237
Non-amortized intangible assets:				
Acquired client relationships— mutual fund management contracts	197,323	—	245,051	—
Goodwill	751,607	—	888,567	—

For the Company's majority-owned investments, definite-lived acquired client relationships are amortized using the straight-line method over a weighted average life of approximately 13 years. Amortization expense was \$14,529, \$16,176 and \$18,339 for the years ended December 31, 2002, 2003 and 2004, respectively. The Company estimates that amortization expense will be approximately \$22,000 per year from 2005 through 2009, assuming no additional investments in new or existing Affiliates.

Amortizable acquired client relationships recorded in connection with the Company's investment in AQR in 2004 are amortized using the straight-line method over a weighted average life of approximately 10 years. Amortization expense was \$908 from the date of investment through December 31, 2004. The Company estimates that AQR amortization expense will be approximately \$8,500 per year from 2005 through 2009, assuming no additional investments in AQR.

As a result of the issuance of Affiliate equity interests to certain employees (see Note 15), the Company's Affiliate ownership percentage in those Affiliates decreased. Accordingly, the Company reported a decrease in its stockholders' equity and the carrying value of its investment, primarily goodwill and acquired client relationships, of approximately \$7.5 million.

## 15. 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 stock certificate. Any such Preferred Stock issued by the Company may rank prior to 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.

### **Common Stock**

In April 2000, the Company's Board of Directors authorized a share repurchase program permitting AMG to repurchase up to 5% of its issued and outstanding shares of common stock. In July 2002 and April 2003, the Board of Directors approved an increase to the existing share repurchase program, in each case authorizing AMG's repurchase of up to an additional 5% of its issued and outstanding shares of common stock. In January 2004, the Company's Board of Directors authorized share repurchase programs in connection with the issuance of the Company's 2004 PRIDES, pursuant to which the Company was authorized to repurchase (i) up to 3.0 million shares of common stock at the time of the closing of the Company's 2004 PRIDES and (ii) an additional 1.5 million shares through February 2005. The timing and amount of purchases are determined at the discretion of AMG's management. In the year ended December 31, 2003, AMG repurchased 1.1 million shares of common stock at an average price of \$30.16 per share. In the year ended December 31, 2004, the Company repurchased 3.5 million shares of common stock at an average price of \$55.72 per share.

In October 2004, the Company entered into a forward equity sale agreement with a major securities firm. Under the terms of the agreement, the Company can elect to deliver a specified number of shares of common stock at any time until October 2005, in exchange for proceeds of approximately \$100,000. Alternatively, the Company can cancel the transaction at any time. Upon cancellation, the Company may net settle the forward agreement in stock, cash, or a combination thereof. Under certain circumstances, the Company can be required to settle the forward equity sale agreement by delivering shares of common stock. The Company will not receive any proceeds from the sale of its common stock until settlement of all or a portion of the forward equity sale agreement. In connection with this agreement, the counterparty borrowed approximately 1.9 million shares of AMG common stock in the stock loan market and sold these shares pursuant to AMG's existing shelf registration statement.

## Convertible Securities

The Company's 2004 PRIDES contain freestanding forward contracts that require holders to purchase shares of the Company's common stock at a certain date in the future. Additionally, the Company's zero coupon and floating rate convertible securities both contain an embedded right for holders to receive shares of the Company's common stock under certain conditions. All of these arrangements and the forward equity sale agreement (described above) meet the definition of equity under FASB Emerging Issues Task Force Abstract No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock" and are not considered derivative instruments under FAS 133 or required to be accounted for separately.

## Stock Option and Incentive Plans

The Company established the 1997 Stock Option and Incentive Plan (as amended and restated), under which it is authorized to grant options to employees, directors and other key persons. In 2002, stockholders approved an amendment to increase the number of shares of common stock authorized for issuance under this plan to 7,875,000.

In 2002, the Company's Board of Directors established the 2002 Stock Option and Incentive Plan, under which the Company is authorized to grant non-qualified stock options and certain other awards to employees and directors. This plan requires that the majority of grants under the plan in any three-year period must be issued to employees of the Company who are not executive officers or directors of the Company. This plan has not been approved by the Company's shareholders. There are 3,375,000 shares of the Company's common stock authorized for issuance under this plan.

The plans are administered by a committee of the Board of Directors. The exercise price of the stock options is the fair market value of the common stock on the date of grant, or such other amount as the committee may determine in

accordance with the relevant plan. The options expire seven to ten years after the grant date.

In December 2003, the Board of Directors approved an amendment to each of the Company's stock option agreements to accelerate the vesting of the then-outstanding unvested options. The shares issuable upon the exercise of the accelerated options remain subject to restrictions on transfer which lapse according to specified schedules, for so long as the option holder remains employed by the Company. In the event the option holder ceases to be employed, the transferability restrictions will remain outstanding until December 2010. All shares received upon exercise remain the property of the holder under any circumstance subject to transfer restrictions.

The following table summarizes the transactions of the Company's stock option and incentive plans:

	Number of Shares	Weighted Average Exercise Price
Unexercised options outstanding – December 31, 2001	5,117,112	\$ 30.77
Activity in 2002		
Options granted	1,452,000	31.43
Options exercised	(167,477)	19.95
Options forfeited	(1,125)	40.11
Unexercised options outstanding – December 31, 2002	6,400,510	\$ 31.20
Activity in 2003		
Options granted	1,873,312	43.20
Options exercised	(515,111)	22.46
Options forfeited	(55,407)	37.41
Unexercised options outstanding – December 31, 2003	7,703,304	\$ 34.66
Activity in 2004		
Options granted	1,931,250	53.93
Options exercised	(717,577)	27.31
Options forfeited	(122,221)	41.99
Unexercised options outstanding – December 31, 2004	8,794,756	\$ 39.39
Exercisable options		
December 31, 2002	3,323,803	\$ 27.61
December 31, 2003	7,703,304	34.66
December 31, 2004	8,794,756	39.39



The following table summarizes information about the Company's stock options at December 31, 2004:

Range of Exercise Prices	Options Outstanding		Options on Which Transferability Restriction has Lapsed		
	Number Outstanding as of 12/31/04	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number Outstanding as of 12/31/04	Weighted Average Exercise Price
\$ 0-10	1,950	3.8	\$ 9.50	1,950	\$ 9.50
10-20	910,685	4.2	18.09	910,685	18.09
20-30	911,975	4.9	25.50	737,314	25.20
30-40	2,426,867	5.2	35.34	2,077,925	35.57
40-50	3,580,154	6.9	44.91	1,486,383	45.11
50-60	75,000	9.3	50.51	18,750	50.51
60-70	888,125	9.9	63.38	—	—
	8,794,756		\$39.39	5,233,007	\$33.82

The Company periodically issues Affiliate equity interests to certain Affiliate employees. The estimated fair value of equity granted in these awards, net of estimated forfeitures, is recorded as compensation expense over the service period as equity-based compensation.

## 16. Earnings Per Share

The calculation of basic earnings per share is based on the weighted average number of shares of the Company's common stock outstanding during the period. Diluted earnings per share is similar to basic earnings per share, but adjusts for the effect of the potential issuance of incremental shares of the Company's common stock. The following is a reconciliation of the numerator and denominator used in the calculation of basic and diluted earnings per share available to common stockholders. Unlike all other dollar amounts in these Notes, the amounts in the numerator reconciliation are not presented in thousands.

	2002	2003	2004
Numerator:			
Net Income	\$ 55,942,000	\$ 60,528,000	\$ 77,147,000
Interest expense on contingently convertible securities, net of taxes	2,069,000	2,293,000	3,016,000
Net income, as adjusted	\$ 58,011,000	\$ 62,821,000	\$ 80,163,000
Denominator:			
Average shares outstanding – basic	33,029,223	31,867,989	29,994,560
Effect of dilutive instruments:			
Stock options	836,626	838,788	1,552,613
Forward equity agreement	—	—	41,550
Contingently convertible securities	4,374,742	7,406,263	8,055,953
Average shares outstanding – diluted	38,240,591	40,113,040	39,644,676

The computation of diluted earnings per share in the years ended December 31, 2002, 2003 and 2004 excludes the effect of the potential exercise of options to purchase approximately 0.9, 2.9 and 0.9 million common shares, respectively, because the effect would be anti-dilutive. This calculation also excludes the effect of any potential exercise of the forward purchase contract component of the 2001 or 2004 PRIDES because the effect would have been anti-dilutive.

As discussed more fully in Note 15, in October of 2004, the Company entered into a forward equity sale agreement under which the Company can elect to issue approximately 1.9 million shares and receive proceeds of \$100,000 at any time until October 18, 2005. The Company can elect instead to net settle the agreement for cash or stock. In accordance with generally accepted accounting principles, the Company used the treasury stock method and included the potentially issuable

shares attributable to this agreement in the computation of diluted earnings per share.

Also, as more fully discussed in Note 7, the Company had zero coupon convertible notes outstanding in 2002, 2003 and 2004 and floating rate convertible securities outstanding in 2003 and 2004. These notes, which comprise the Company's contingently convertible securities, are convertible into shares of the Company's common stock upon certain conditions. During the fourth quarter of 2004, the Company adopted EITF 04-08. Under EITF 04-08, the aggregate number of shares of common stock that could be issued in the future to settle these securities are deemed outstanding for the purposes of the calculation of diluted earnings per share. This approach, the if-converted method, requires that such shares be deemed outstanding regardless of whether the issuance of those shares could actually be triggered. For this if-converted calculation, the interest expense (net of taxes) attributable to these securities is added back to Net Income, reflecting the assumption that the securities have been converted.

For the years ended December 31, 2002, 2003 and 2004, the Company repurchased a total of 872,700, 1,116,750 and 3,486,512 shares, respectively, of common stock under various stock repurchase programs.

## 17. Financial Instruments and Risk Management

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

### Notional amounts and credit exposures of derivatives

The notional amount of derivatives does 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 counterparties that issued the financial instruments, although the Company does not expect that the counterparties to interest rate swaps will fail to meet their obligations, given their typically 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 because of its own credit rating and that of its counterparties.

### Interest Rate Risk Management

From time to time, 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 are intended to enable the Company to achieve a level of variable-rate and fixed-rate debt that is acceptable to management and to limit 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.

### Fair Value

Financial Accounting Standard No. 107 ("FAS 107"), "Disclosures about Fair Value of Financial Instruments," 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 by 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 typically plans to settle liabilities prior to contractual maturity. Additionally, FAS 107 allows companies to use a wide range of valuation techniques; therefore, it may be difficult to compare the Company's fair value information to other companies' fair value information.

The carrying amount of cash, cash equivalents and short-term investments 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 notes. The carrying value of senior bank debt approximates fair value because the debt is a revolving credit facility with variable interest based on selected short-term rates. The fair market value of the zero coupon senior convertible debt, the floating rate senior convertible securities, and the 2004 mandatory convertible debt at December 31, 2004 was \$160,560, \$483,000 and \$300,000, respectively.

## 18. Selected Quarterly Financial Data (Unaudited)

The following is a summary of the quarterly results of operations of the Company for the years ended December 31, 2003 and 2004.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
<b>2003</b>				
Revenue	\$ 110,247	\$ 116,701	\$ 128,465	\$ 139,616
Operating income	41,922	46,157	50,598	58,838
Income before income taxes	21,662	23,039	27,788	29,343
Net Income	12,997	13,823	16,395	17,313
Earnings per share – diluted	\$ 0.35	\$ 0.36	\$ 0.42	\$ 0.44
<b>2004</b>				
Revenue	\$ 151,634	\$ 158,562	\$ 165,846	\$ 183,955
Operating income	61,660	66,412	64,397	75,413
Income before income taxes	30,797	31,534	27,998	38,764
Net Income	18,170	18,920	16,799	23,258
Earnings per share – diluted	\$ 0.47	\$ 0.51	\$ 0.46	\$ 0.58

The earnings per share measures presented above reflect the retroactive application of EITF 04-08 to each of the periods presented (see Note 1). If the Company did not apply EITF 04-08 to these periods, the measures would have been higher by approximately 15% in 2003 and 17% in 2004.

In each of the quarters in the year ended December 31, 2004, the Company experienced an increase in revenue, operating income, income before income taxes, Net Income and earnings per share from the same period in 2003, primarily as a result of positive investment performance and, to a lesser extent, the Company's new investments in 2004. In the third quarter of 2004, the Company reported a one-time charge of \$2.5 million on the repurchase of the debt component of certain of its

2001 PRIDES units. This charge contributed to declines in operating income, income before tax and net income from the second quarter of 2004, despite a 5% increase in revenue in this period.

## 19. Related Party Transactions

The Company recorded amounts payable to Affiliate partners of \$938 and \$18,518 in connection with the purchase of additional Affiliate equity interests in 2003 and 2004, respectively. The total amount due to Affiliate partners as of December 31, 2004 was \$35,455, of which \$17,728 is due in 2005 and is included as a current liability.

## 20. Segment Information

Financial Accounting Standard No. 131, “Disclosures about Segments of an Enterprise and Related Information” (“FAS 131”), establishes disclosure requirements relating to operating segments in annual and interim financial statements. Management has assessed the requirements of FAS 131 and determined that the Company operates in three business segments representing the Company’s three principal distribution channels: Mutual Fund, Institutional and High Net Worth, each of which has different client relationships.

Revenue in the Mutual Fund distribution channel is earned from advisory and sub-advisory relationships with mutual funds. Revenue in the Institutional distribution channel is earned from relationships with foundations and endowments, defined benefit and defined contribution plans and Taft-Hartley plans. Revenue in the High Net Worth distribution channel is earned from relationships with wealthy individuals, family trusts and managed account programs. In the case of Affiliates with transaction-based brokerage fee businesses, revenue reported in each distribution channel includes fees earned for transactions on behalf of clients in that channel.

In firms with revenue sharing arrangements, a certain percentage of revenue is allocated for use by management of an Affiliate in paying operating expenses of that Affiliate, including salaries and bonuses, and is called an “Operating Allocation.” In reporting segment operating expenses, Affiliate expenses are allocated to a particular segment on a pro rata basis with respect to the revenue generated by that Affiliate in such segment. Generally, as revenue increases, additional compensation is typically paid to Affiliate management partners from the Operating Allocation. As a result, the contractual expense allocation pursuant to a revenue sharing arrangement may result in the characterization of any growth in profit margin beyond the Company’s Owners’ Allocation as an operating expense. All other operating expenses (excluding intangible amortization) and interest expense have been allocated to segments based on the proportion of cash flow distributions reported by Affiliates in each segment.



2002	Mutual Fund	Institutional	High Net Worth	Total
Revenue	\$ 164,607	\$ 178,140	\$ 139,789	\$ 482,536
Operating expenses:				
Depreciation and amortization	1,197	13,057	6,122	20,376
Other operating expenses	89,849	99,091	77,392	266,332
	91,046	112,148	83,514	286,708
Operating income	73,561	65,992	56,275	195,828
Non-operating (income) and expenses:				
Investment and other income	(1,222)	(1,295)	(956)	(3,473)
Interest expense	8,573	8,646	7,998	25,217
	7,351	7,351	7,042	21,744
Income before minority interest and income taxes	66,210	58,641	49,233	174,084
Minority interest	(28,176)	(31,400)	(21,270)	(80,846)
Income before income taxes	38,034	27,241	27,963	93,238
Income taxes	15,213	10,898	11,185	37,296
Net Income	\$ 22,821	\$ 16,343	\$ 16,778	\$ 55,942
Total assets	\$ 498,154	\$ 454,613	\$ 290,227	\$ 1,242,994
Goodwill	\$ 268,534	\$ 289,312	\$ 181,207	\$ 739,053
2003				
Revenue	\$ 191,740	\$ 171,798	\$ 131,491	\$ 495,029
Operating expenses:				
Depreciation and amortization	1,560	14,154	6,693	22,407
Other operating expenses	102,061	96,769	76,277	275,107
	103,621	110,923	82,970	297,514
Operating income	88,119	60,875	48,521	197,515
Non-operating (income) and expenses:				
Investment and other income	(2,861)	(1,846)	(3,538)	(8,245)
Interest expense	9,237	7,235	6,504	22,976
	6,376	5,389	2,966	14,731
Income before minority interest and income taxes	81,743	55,486	45,555	182,784
Minority interest	(33,487)	(28,800)	(18,665)	(80,952)
Income before income taxes	48,256	26,686	26,890	101,832
Income taxes	19,578	10,831	10,895	41,304
Net Income	\$ 28,678	\$ 15,855	\$ 15,995	\$ 60,528
Total assets	\$ 628,417	\$ 560,483	\$ 330,305	\$ 1,519,205
Goodwill	\$ 272,917	\$ 296,012	\$ 182,678	\$ 751,607
2004				
Revenue	\$ 255,153	\$ 265,770	\$ 139,074	\$ 659,997
Operating expenses:				
Depreciation and other amortization	1,658	13,905	9,145	24,708
Other operating expenses	139,972	146,360	81,075	367,407
	141,630	160,265	90,220	392,115
Operating income	113,523	105,505	48,854	267,882
Non-operating (income) and expenses:				
Investment and other income	(4,343)	(2,871)	(1,246)	(8,460)
Interest expense	12,746	12,142	6,837	31,725
	8,403	9,271	5,591	23,265
Income before minority interest and taxes	105,120	96,234	43,263	244,617
Minority interest	(44,078)	(50,541)	(20,905)	(115,524)
Income before income taxes	61,042	45,693	22,358	129,093
Income taxes	24,566	18,371	9,009	51,946
Net Income	\$ 36,476	\$ 27,322	\$ 13,349	\$ 77,147
Total assets	\$ 719,307	\$ 844,454	\$ 369,660	\$ 1,933,421
Goodwill	\$ 299,289	\$ 398,284	\$ 190,994	\$ 888,567

As of December 31, 2004 an equity method investment of approximately \$252,000 included in the total assets of the Institutional segment.

## **21. Subsequent Events**

On January 14, 2005, the Company completed, through its Affiliate, Managers Investment Group LLC (the successor to The Managers Funds LLC), the acquisition of approximately \$3.0 billion of assets under management from Fremont Investment Advisors, Inc. ("FIA"). The acquisition includes the Fremont Funds, a diversified family of 12 no-load mutual funds managed by independent sub-advisors and investment professionals at FIA, as well as FIA assets in separate accounts and 401(k) plans. The transaction was financed through the Company's available cash.

## Common Stock and Corporate Organization Information

### Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is traded on the New York Stock Exchange (symbol: AMG). The following table sets forth the high and low prices as reported on the New York Stock Exchange composite tape since January 1, 2003 for the periods indicated. These prices reflect a three-for-two stock split that occurred in March 2004.

2003	High	Low
First Quarter	\$ 37.41	\$ 24.35
Second Quarter	43.25	27.37
Third Quarter	46.18	39.73
Fourth Quarter	48.74	41.71
2004		
First Quarter	\$ 58.89	\$ 46.36
Second Quarter	57.45	45.10
Third Quarter	54.47	43.20
Fourth Quarter	67.92	53.50
2005		
First Quarter <sup>(1)</sup>	\$ 68.09	\$ 60.25

(1) Data for this period reflects high and low prices from January 1, 2005 through March 8, 2005.

The closing price for a share of our common stock as reported on the New York Stock Exchange composite tape on March 8, 2005 was \$65.86. As of March 8, 2005, there were 34 stockholders of record.

We have not declared a cash dividend with respect to the periods presented. Since we intend to retain earnings to finance investments in new Affiliates, repay indebtedness, pay interest and income taxes, repurchase debt securities and shares of our common stock when appropriate, and develop our existing business, and since our credit facility prohibits us from making cash dividend payments to our stockholders, we do not anticipate paying cash dividends on our common stock in the foreseeable future.

### Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(1)</sup>	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs <sup>(2)</sup>
October 1 - 31, 2004	—	—	—	3,025,203
November 1 - 30, 2004	—	—	—	3,025,203
December 1 - 31, 2004	—	—	—	3,025,203
Total	—	—	—	

(1) Note 15 to the Consolidated Financial Statements provides additional detail with respect to our share repurchase programs.

(2) As of March 8, 2005, there were 1,950,215 shares that could be purchased under our share repurchase programs.

### Employees and Corporate Organization

As of December 31, 2004, we had 60 employees and our Affiliates employed approximately 914 persons. Approximately 923 of these 974 employees were full-time employees. Neither we nor any of our Affiliates is subject to any collective bargaining agreements, and we believe that our labor relations are good. We were formed in 1993 as a corporation under the laws of the State of Delaware.

## Endnotes

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### Notes to Financial Highlights

- (1) Cash Net Income is defined as Net Income plus amortization and deferred taxes related to intangible assets plus Affiliate depreciation. AMG's use of Cash Net Income, including a reconciliation to Net Income, is discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations." As discussed in that section, in 2003, in connection with AMG's issuance of convertible securities, AMG modified this definition to clarify that deferred taxes relating to these convertible securities and certain depreciation are not added back for the calculation of Cash Net Income. If we had used this definition of Cash Net Income beginning in 2002, Cash Net Income for 2002 would have been \$97.6 million.
- (2) Earnings before interest expense, income taxes, depreciation and amortization.
- (3) Earnings per share and diluted average shares outstanding reflect a three-for-two stock split that occurred in March 2004 and the retroactive application of EITF 04-08 to each of the periods presented.
- (4) Cash Net Income (as described in Note 1, above) divided by the adjusted diluted average shares outstanding (see Note 5).
- (5) In the calculation of adjusted diluted average shares outstanding, the potential share issuance in connection with the Company's contingently convertible securities measures net shares using a "treasury stock" method. Under this method, only the net number of shares of common stock equal to the value of the contingently convertible securities in excess of par, if any, are deemed to be outstanding. The Company believes the inclusion of net shares under a treasury stock method best reflects the benefit of the increase in available capital resources (which could be used to repurchase shares of common stock) that occurs when these securities are converted and the Company is relieved of its debt obligation. This method does not take into account any increase or decrease in the Company's cost of capital in an assumed conversion.

### Other Notes

- (1) Unless otherwise noted, data presented is as of December 31, 2004, and is pro forma for completed investments and the Company's acquisition of the Fremont Funds.
- (2) Investment product and performance information has been provided by each Affiliate to AMG, and is provided in this Annual Report for reference purposes only and not for investment or solicitation purposes. The investment performance of Affiliate products is compared to benchmarks deemed by the Affiliates and AMG to be the appropriate benchmarks for such products. The returns referenced are net of expenses, while returns of any applicable indices are before expenses; in each case, the return and applicable index information is as of December 31, 2004.
- (3) Index performance data has been compiled by the respective firm for comparison purposes, and the accuracy or reliability of the data is not guaranteed by such firm. Except as otherwise indicated, the products described herein are not sponsored or endorsed and have not been reviewed or passed on by the referenced firm. In no event shall any of these firms, their affiliates, or any related data provider, have any liability of any kind in connection with the data or the products described herein.
  - Credit Suisse First Boston/Tremont Index LLC produces the CSFB/Tremont Hedge Fund Index, an asset-weighted index of hedge funds.
  - Frank Russell Company produces the Russell 3000® Index, a market-cap weighted index that measures the performance of the 3,000 largest U.S. companies based on total market capitalization. The Russell 3000® Growth Index measures the performance of those Russell 3000 companies with higher price-to-book ratios and higher forecasted growth values. The Russell 2000® Index, a market cap-weighted index, measures the performance of the 2,000 smallest companies in the Russell 3000® Index. The Russell 2000® Growth Index measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values. The Russell 2500™ Index measures the performance of the 2,500 smallest companies in the Russell 3000 Index. The Russell 2500™ Growth Index measures the performance of those Russell 2,500 companies with higher price-to-book ratios and higher forecasted growth values.
  - Lipper Inc., a wholly owned subsidiary of Reuters, is a global leader in supplying mutual fund information, analytical tools, and commentary. The Lipper Fund Awards 2005 recognize fund families that deliver consistently strong relative performance. Eligible smaller fund groups must have at least three portfolios in an asset class and less than \$21.6 billion in total assets.
  - Morgan Stanley Capital International produces the MSCI EAFE (Europe, Australia, & Far East) and MSCI EMF (Emerging Markets Free) Indices. The MSCI EAFE Index is an unmanaged market cap-weighted index of equity securities of companies domiciled in 21 developed equity markets outside the U.S., including Japan, Australia, Hong Kong, New Zealand, Singapore, the U.K. and the Eurozone countries. The MSCI EMF Index is an unmanaged market cap-weighted index of equity securities of companies representative of the market structure of 22 emerging market countries in Europe, Latin America and the Pacific Basin.
  - Morningstar Inc. is a leading provider of mutual fund, stock, and variable-insurance investment information. Morningstar's risk-adjusted star rating brings both return and risk together into one evaluation by subtracting the fund's Morningstar Risk score from its Morningstar Return score. If the fund's score places it in the top 10% of its broad ratings group, it receives 5 stars; if it falls in the next 22.5%, it receives 4 stars; a place in the middle 35% earns it 3 stars; those in the next 22.5% receive 2 stars; and the bottom 10% get 1 star. The star ratings are recalculated monthly.
  - Standard & Poor's, a division of The McGraw-Hill Companies, Inc., produces the S&P 500 Index, a market cap-weighted index consisting of 500 stocks chosen for market size, liquidity, and industry group representation to represent U.S. equity performance.



### Corporate Offices

Affiliated Managers Group, Inc.  
600 Hale Street  
Prides Crossing, Massachusetts 01965  
617.747.3300  
www.amg.com

### Independent Auditors

PricewaterhouseCoopers LLP  
Boston, Massachusetts

### Transfer Agent and Registrar

LaSalle Bank, NA  
Chicago, Illinois

### Stock Exchange Listing

New York Stock Exchange  
Ticker Symbol: AMG

### Annual Meeting

The Annual Meeting of Stockholders will be held at AMG's offices in Prides Crossing, Massachusetts, on June 1, 2005.

### Form 10-K

Copies of the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission may be obtained without charge by requesting them from:

Investor Relations  
Affiliated Managers Group, Inc.  
600 Hale Street  
Prides Crossing, Massachusetts 01965

This Annual Report to Stockholders contains forward-looking statements. There are a number of important factors that could cause AMG's actual results to differ materially from those indicated by such forward-looking statements including, but not limited to, those listed elsewhere in this Annual Report and in the Section titled "Business-Cautionary Statements" in the Company's Annual Report on Form 10-K for the year ended December 31, 2004 as filed with the Securities and Exchange Commission.

### Board of Directors

Richard E. Floor  
Partner,  
Goodwin Procter LLP

Sean M. Healey  
President and Chief Executive Officer

Stephen J. Lockwood  
Managing Director,  
Stephen J. Lockwood & Company, LLP

Harold J. Meyerman  
Private Investor

William J. Nutt  
Chairman

Robert C. Puff, Jr.  
Former President,  
American Century Investment Management, Inc.

Rita M. Rodriguez  
Former Director,  
Export-Import Bank of the United States

### Executive Officers

William J. Nutt  
Chairman

Sean M. Healey  
President and Chief Executive Officer

Seth W. Brennan  
Executive Vice President, New Investments

Darrell W. Crate  
Executive Vice President and Chief Financial Officer

Nathaniel Dalton  
Executive Vice President, Affiliate Development

John Kingston, III  
Senior Vice President and General Counsel

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[www.amg.com](http://www.amg.com)

600 Hale Street  
Prides Crossing, MA 01965  
617.747.3300