

AFFILIATED MANAGERS GROUP INC  
Form 10-K  
February 29, 2008

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

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**FORM 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Fiscal year ended December 31, 2007

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 001-13459

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**AFFILIATED MANAGERS GROUP, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**04-3218510**

(IRS Employer Identification Number)

**600 Hale Street, Prides Crossing, Massachusetts**

(Address of principal executive offices)

**01965**

(Zip Code)

**(617) 747-3300**

(Registrant's telephone number, including area code)

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

**Common Stock (\$.01 par value)**

Title of each class

**New York Stock Exchange**

Name of each exchange on which registered

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

**None**

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been

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subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>
		(Do not check if a smaller reporting company)	

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

At June 29, 2007, the aggregate market value of the common stock held by non-affiliates of the registrant, based upon the closing price of \$128.76 on that date on the New York Stock Exchange, was \$3,805,191,231. Calculation of holdings by non-affiliates is based upon the assumption, for this purpose only, that executive officers, directors and persons holding 10% or more of the registrant's common stock are affiliates. There were 36,442,613 shares of the registrant's common stock outstanding on February 26, 2008.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held on or about June 3, 2008 are incorporated by reference into Part III.

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**PART I**

**Item 1. Business**

We are an asset management company with equity investments in a diverse group of boutique investment management firms (our "Affiliates"). We pursue a growth strategy designed to generate shareholder value through the internal growth of our existing business, additional investments in investment management firms and strategic transactions and relationships structured to enhance our Affiliates' businesses and growth prospects.

In our investments in each of our Affiliates, we hold a substantial equity interest. The remaining equity interests are retained by the management of the Affiliate and enable Affiliate managers to continue to participate in their firm's success. Our investment approach provides a degree of liquidity and diversification to principal owners of boutique investment management firms, and also addresses the succession and ownership transition issues facing many founders and principal owners. Our partnership approach also ensures that Affiliates maintain operational autonomy in managing their business, thereby preserving their firm's entrepreneurial culture and independence. In particular, our structures are designed to:

maintain and enhance Affiliate managers' equity incentives in their firms;

preserve each Affiliate's distinct culture and investment focus; and

provide Affiliates with the ability to realize the benefits of scale economies in distribution, operations, compliance and technology.

Although we invest in firms that we anticipate will grow independently and without our assistance, we are committed to helping Affiliates identify opportunities for growth and leverage the benefits of economies of scale. We assist our Affiliates in broadening distribution in the United States and globally, developing new products and providing strategic support and enhanced operational capabilities.

We believe that substantial opportunities to make investments in high-quality boutique investment management firms will continue to arise as their founders seek to institutionalize their businesses through broader equity ownership, or approach retirement age and begin to plan for succession. Our management identifies select firms based on our thorough understanding of the asset management industry, and has developed relationships with a significant number of these firms. Within our target universe, we seek the strongest and most stable firms with the best growth prospects, which are typically characterized by a strong multi-generational management team and culture of commitment to building a firm for its longer-term success, focused investment discipline and long-term investment track record, and diverse products and distribution channels. We are focused on investing in the highest quality boutique asset management firms specializing in an array of investment styles and asset classes, including both traditional and alternative investment managers. We anticipate that we will have significant additional investment opportunities across the investment management industry in the United States and globally, including the potential for investments in subsidiaries, divisions and other investment teams or products.

**Investment Management Operations**

Through our Affiliates, we manage approximately \$274.8 billion in assets (as of December 31, 2007) in more than 300 investment products across a broad range of asset classes and investment styles in three principal distribution channels: Mutual Fund, Institutional and High Net Worth. 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.

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A summary of selected financial data attributable to our operations follows:

<i>(in millions, except as noted)</i>	<u>2005</u>	<u>2006</u>	<u>2007</u>
<b>Assets under Management (in billions)<sup>(1)</sup></b>			
Mutual Fund	\$ 50.3	\$ 58.2	\$ 62.2
Institutional	109.3	154.7	180.4
High Net Worth	24.7	28.2	32.2
<b>Total</b>	<b>\$ 184.3</b>	<b>\$ 241.1</b>	<b>\$ 274.8</b>
<b>Revenue<sup>(2)</sup></b>			
Mutual Fund	\$ 400.9	\$ 501.7	\$ 558.3
Institutional	385.7	514.8	645.6
High Net Worth	129.9	153.9	166.0
<b>Total</b>	<b>\$ 916.5</b>	<b>\$ 1,170.4</b>	<b>\$ 1,369.9</b>
<b>Net Income<sup>(3)</sup></b>			
Mutual Fund	\$ 56.8	\$ 68.0	\$ 72.5
Institutional	51.3	65.8	87.9
High Net Worth	11.0	17.5	21.6
<b>Total</b>	<b>\$ 119.1</b>	<b>\$ 151.3</b>	<b>\$ 182.0</b>
<b>EBITDA<sup>(3)(4)</sup></b>			
Mutual Fund	\$ 110.3	\$ 138.2	\$ 153.9
Institutional	125.2	162.3	211.3
High Net Worth	32.0	41.6	53.0
<b>Total</b>	<b>\$ 267.5</b>	<b>\$ 342.1</b>	<b>\$ 418.2</b>

(1) Balances as of December 31.

(2) In 2005, 2006 and 2007, revenue attributable to clients domiciled outside the U.S. was approximately 13%, 15% and 18%, respectively.

(3) Note 26 to the Consolidated Financial Statements describes the basis of presentation of our distribution channel operating results. For purposes of our distribution channel operating results, expenses not incurred directly by Affiliates have been allocated based on the proportion of aggregate cash flow distributions reported by each Affiliate in the particular distribution channel.

(4) 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 "Management's Discussion and Analysis of Financial Condition and Results of Operations."

In November 2007, we acquired a minority interest in ValueAct Capital ("ValueAct"), a San Francisco-based alternative investment firm that establishes ownership interests in undervalued companies and works with each company's management and Board of Directors to implement business strategies that enhance shareholder value. ValueAct has over 250 clients, including endowments, foundations, corporations,

family offices, high net worth investors and funds of funds.

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In December 2007, we acquired a minority interest in BlueMountain Capital Management ("BlueMountain"), a leading global credit alternatives manager specializing in relative value strategies in the corporate loan, bond, credit and equity derivatives markets. BlueMountain has offices in New York and London, and manages assets on behalf of predominantly institutional and high net worth clients.

### ***Mutual Fund Distribution Channel***

Through our Affiliates, we provide advisory or sub-advisory services to more than 100 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.

Our largest mutual funds in this distribution channel are the:

Tweedy, Browne Global Value and Value Funds, managed by Tweedy, Browne Company LLC ("Tweedy, Browne"), a New York-based investment advisor that employs a value-oriented investment approach advocated by Benjamin Graham to invest in global and domestic securities;

Third Avenue Value Funds, including the Third Avenue Value, Real Estate Value, Small Cap Value and International Value Funds, which are managed by Third Avenue Management LLC ("Third Avenue"), a New York-based investment advisor that employs a deep value approach to investing in equities, real estate and corporate debt securities;

Brandywine, Brandywine Blue and Brandywine Advisors Funds, which are managed by Friess Associates, LLC ("Friess Associates"), a Delaware and Wyoming-based investment advisor that invests in growth equities through an intensive, bottom up research process; and

Managers Funds and Managers AMG Funds, a complex of 32 funds for which Managers Investment Group LLC ("Managers") serves as the manager of managers, employing a search, selection and monitoring process to identify sub-advisors for the Managers Funds, and through Managers AMG Funds, offering retail investors access to Affiliates' investment management services otherwise available only through Institutional separate accounts.

Utilizing Managers' distribution, sales, client service and back-office capabilities, our Affiliates are provided access to the Mutual Fund distribution channel and wrap sponsor platforms. Managers offers Affiliates a single point of contact for retail intermediaries such as banks, brokerage firms and other sponsored platforms. Within this distribution channel, Managers is presently servicing and distributing approximately 40 mutual funds, including funds managed by eight Affiliates.

### ***Institutional Distribution Channel***

Through our Affiliates, we offer approximately 200 investment products across approximately 50 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, credit arbitrage and fixed income products. In 2007 we expanded our product offerings in the Institutional distribution channel through our investments in ValueAct and BlueMountain. 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.

Our institutional investment products are distributed by over 50 sales and marketing professionals at our Affiliates who develop new institutional business through direct sales efforts and established relationships with pension consultants. Our efforts are designed to ensure that our Affiliates' products

and services successfully address the specialized needs of their clients and are responsive to the evolving demands of the marketplace and provide our 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.

In 2007, we continued to work with our Affiliates in executing and enhancing their marketing and client service initiatives by establishing a global distribution platform. Our first distribution office, located in Sydney, Australia, opened in February 2007. Through this platform, we provide institutional investors in Australia and New Zealand a single point of contact to access a broad range of investment products offered by our Affiliates. The diverse products available include quantitative strategies focused on both U.S. and global equities, as well as global, international and U.S. value equity, real estate, and distressed and other special situations. As of December 31, 2007, our Affiliates managed approximately \$8.5 billion for clients in Australia and New Zealand. In February 2008, we announced the opening of an office in London, England, extending the global institutional distribution capabilities for our Affiliates to the Middle East.

#### ***High Net Worth Distribution Channel***

The High Net Worth distribution channel is comprised broadly of two principal client groups. The first group consists principally of direct relationships with high net worth 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, which are generally brokerage firms or other sponsors. Our Affiliates provide investment management services through more than 90 managed account programs.

We have undertaken several initiatives to provide our Affiliates with enhanced managed account distribution and administration capabilities. Within our High Net Worth distribution channel, Managers is presently distributing approximately 40 investment products managed by nine Affiliates. Managers distributes single and multi-manager separate account products and mutual funds through brokerage firms.

#### ***Our Structure and Relationship with Affiliates***

In making investments in boutique asset management firms, we seek to partner with the highest quality firms in the industry, with outstanding management teams, strong long-term performance records and a demonstrated commitment to continued growth and success. Fundamental to our investment approach is the belief that Affiliate management equity ownership (along with AMG's ownership) aligns our interests and provides Affiliate managers with a powerful incentive to continue to grow their business. Our investment structure provides a degree of liquidity and diversification to principal owners of boutique investment management firms, while at the same time expanding equity ownership opportunities among the firm's management and allowing management to continue to participate in the firm's future growth. Our partnership approach also ensures that Affiliates maintain operational autonomy in managing their business, thereby preserving their firm's entrepreneurial culture and independence.

Although the specific structure of each investment is highly tailored to meet the needs of a particular Affiliate, in all cases, AMG establishes a meaningful equity interest in the firm, with the remaining equity interests retained by the management of the Affiliate. Each Affiliate is organized as a separate firm, and its operating or shareholder agreement is structured to provide appropriate incentives for Affiliate management owners and to address the Affiliate's particular characteristics while also enabling us to protect our interests, including through arrangements such as long-term employment agreements with key members of the firm's management team.



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In most cases, we own a majority of the equity interests of a firm and structure a revenue sharing arrangement, in which a percentage of revenue 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.

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 both the Operating Allocation and the Owners' Allocation. These arrangements also provide incentives to control operating expenses, thereby increasing the portion of the Operating Allocation that is available for growth initiatives and compensation.

An Affiliate's Operating Allocation is structured to cover its operating expenses. However, should actual operating expenses exceed the Operating Allocation, our contractual share of cash under the Owners' Allocation generally has priority over the allocations and distributions to the Affiliate's managers. As a result, the excess expenses first reduce the portion of the Owners' Allocation allocated to the Affiliate's managers until that portion is eliminated, before reducing 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.

Our minority investments are also structured to align our interests with those of the Affiliate's management through shared equity ownership, as well as to preserve the Affiliate's entrepreneurial culture and independence by maintaining the Affiliate's operational autonomy. In cases where we hold a minority interest, a revenue sharing arrangement generally allocates a percentage of the Affiliate's revenue to us. The remaining revenue is used to pay operating expenses and profit distributions to the other owners.

Certain of our Affiliates operate under profit-based arrangements through which we own a majority of the equity in the firm and receive a share of profits as cash flow, rather than a percentage of revenue through a typical revenue sharing agreement. As a result, we participate fully in any increase or decrease in the revenue or expenses of such firms. In these cases, we participate in a budgeting process and generally provide incentives to management through compensation arrangements based on the performance of the Affiliate.

We are focused on establishing and maintaining long-term partnerships with our Affiliates. Our shared equity ownership gives both AMG and our Affiliate partners meaningful incentives to manage their businesses for strong future growth. From time to time, we may consider changes to the structure of our relationship with an Affiliate in order to better support the firm's growth strategy.

### ***Our Purchase of Additional Interests in Our Existing Affiliates***

Many of our Affiliate operating agreements provide our Affiliate managers conditional rights ("put rights") that enable them to sell their retained equity interests to us at certain intervals, gradually over time. These agreements also provide us conditional rights to require the managers to sell their interests to us ("call rights"). We believe these rights enhance our ability to keep our ownership within a desired range and provide Affiliate managers sufficient incentives to grow and improve their business and create equity value for themselves. These rights help facilitate our ability to provide equity ownership opportunities in our Affiliates to more junior members of their management teams.

**Diversification of Assets under Management**

The following table provides information regarding the composition of our assets under management as of December 31, 2007.

	<b>Assets under Management</b>	<b>Percentage of Total</b>
	<i>(in billions)</i>	
<b>Distribution Channel:</b>		
Mutual Fund	\$ 62.2	22%
Institutional	180.4	66%
High Net Worth	32.2	12%
	<b>\$ 274.8</b>	<b>100%</b>
<b>Asset Class:</b>		
Equity <sup>(1)</sup>	\$ 215.7	78%
Alternative <sup>(2)</sup>	46.2	17%
Fixed Income	12.9	5%
	<b>\$ 274.8</b>	<b>100%</b>
<b>Geography<sup>(3)</sup>:</b>		
Domestic	\$ 125.9	46%
Global/International	124.2	45%
Emerging Markets	24.7	9%
	<b>\$ 274.8</b>	<b>100%</b>

- (1) The Equity asset class includes equity, balanced and asset allocation products.
- (2) The Alternative asset class includes multi-strategy, market neutral equity and hedge products.
- (3) The geography of a particular investment product describes the general location of its investment holdings.

**Industry**

**Global Asset Management Industry**

The asset management industry has been a key driver of growth in financial services over the last decade. According to the most recent available data, assets under management across all distribution channels total approximately \$53.4 trillion globally, of which \$25.7 trillion is managed in the United States. We believe long-term prospects for overall industry growth (which has compounded at an annual rate of 16% globally over the past four 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 each of the principal distribution channels for our Affiliates' products.

**U.S. Asset Management Industry**

In the Mutual Fund distribution channel, according to a 2007 industry report, more than 88 million individuals in almost 51 million households in the United States are invested in mutual funds. In 2007, net cash flows to equity mutual funds totaled over \$233 billion, and aggregate mutual fund assets totaled \$11.6 trillion at the end of 2007. 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 in the United States are primarily in retirement plans, including both defined benefit and defined contribution plans, endowments and foundations, and totaled approximately \$14.4 trillion as of December 31, 2006. Although the majority of Institutional assets are in equities (estimated to be 60% in 2006), allocations to alternative investments have continued to increase. According to a recent study of institutional investors, allocations of institutional assets to hedge funds (a core component of alternative investments) have grown from 2.5% of assets in 2001 to 7.5% in 2007, and are expected to increase to 8.9% by 2009. 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 high net worth families and individuals (those having at least \$1 million in investable assets) in the United States had aggregate assets of \$11.3 trillion at the end of 2006; industry experts expect assets in this segment of the channel to grow to \$15.8 trillion by the end of 2011. 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 \$1.1 trillion at the end of 2007 (a nearly 20% increase over year end 2006).

### **Investment Advisors**

AMG's target investment universe includes over 1,800 investment management firms globally, and we have established relationships with approximately 800 of these firms. These firms include both traditional and alternative asset management firms, as well as asset management subsidiaries of larger organizations, strategic distribution firms, and boutique asset management firms outside North America. We believe that a substantial number of investment opportunities will arise as the founders of such firms experience a need for partnership transition and succession planning, or otherwise seek a degree of diversification and additional resources to pursue their growth strategy. We are well positioned to execute upon these investment opportunities because we have an established process for identifying and cultivating investment prospects, as well as substantial experience and expertise in structuring and negotiating transactions. In addition, AMG has a strong reputation as an effective partner to our existing Affiliates, and is widely perceived as an innovative, supportive institutional partner for growing boutique asset management firms.

### **Competition**

In each of our three principal distribution channels, we and our Affiliates compete with a large number of domestic and foreign investment management firms, including public and private companies, subsidiaries of commercial and investment banks and insurance companies. In comparison to us and our Affiliates, these firms generally have greater resources and assets under management, and many offer an even broader array of investment products and services than our Affiliates. Since certain Affiliates are active in the same distribution channels, from time to time they compete with each other for clients. In addition, there are relatively few barriers to entry by new investment management firms, especially in the Institutional distribution channel. We believe that the most important factors affecting our ability to compete for clients in our three principal distribution channels are the:

abilities, performance records and reputation of the Affiliates and their management teams;

products offered;

management fees charged;

level of client service offered; and

development and marketing of new investment strategies and ability to access opportunities.

The relative importance of each of these factors can vary depending on the distribution channel and the type of investment management service involved, as well as general market factors. Each Affiliate's ability to retain and increase assets under management would be adversely affected if client accounts underperform in comparison to relevant benchmarks or peer groups, or if key personnel leave the Affiliate. The ability of each Affiliate to compete with other investment management firms also depends, in part, on the relative attractiveness of its investment philosophies and methods under then-prevailing market conditions.

A component of our growth strategy is the acquisition of equity interests in additional boutique investment management firms. In seeking to acquire such equity interests, we compete with a number of acquirers of investment management firms, including other investment management companies, insurance companies, broker-dealers, banks, private equity firms and sovereign wealth funds. Many of these companies have longer operating histories and greater resources than we do, which may make our competitors more attractive to the owners of the firms in which we are considering an investment and may enable them to offer greater consideration to such owners. We believe that important factors affecting our ability to compete for future investments are the:

degree to which target firms view our investment structure as preferable, financially and operationally, to acquisition or investment arrangements offered by other potential purchasers; and

reputation and performance of our existing and future Affiliates, by which target firms may judge us and our future prospects.

## **Government Regulation**

Our Affiliates' businesses are subject to complex and extensive regulation by various U.S. federal regulatory authorities, certain state regulatory authorities and various non-U.S. regulatory authorities. This regulatory environment may be altered without notice by new regulations, revisions to existing regulations or new interpretations or guidance. Changes in these laws or regulations could have a material adverse impact on our profitability and mode of operations and could require an Affiliate to curtail its investment operations or offerings. Regulatory authorities may also conduct examinations of our Affiliates' operations and any determination that our Affiliates have failed to comply with laws or regulations could result in disciplinary or enforcement action with penalties that may include the disgorgement of fees, fines, suspensions or censure of individual employees or revocation or limitation of an Affiliate's business activities or registration as an investment advisor, commodity trading advisor or broker/dealer. Even in the absence of wrongdoing, regulatory inquiries or proceedings could cause substantial expenditures of time and capital and result in reputational damages.

### ***Regulation in the United States***

Each of our U.S. Affiliates and three of our Affiliates domiciled outside of the U.S. are registered as investment advisors with the U.S. Securities and Exchange Commission under the Investment Advisers Act of 1940, as amended (the "Investment Advisers Act"), and are subject to the provisions of the Investment Advisers Act and related regulations. The Investment Advisers Act requires registered investment advisors to comply with numerous obligations, including implementation of compliance policies and procedures, record keeping requirements, operational procedures and disclosure

obligations. Moreover, many of our Affiliates act as advisors or sub-advisors to mutual funds, which are registered as investment companies with the U.S. Securities and Exchange Commission pursuant to the Investment Company Act of 1940, as amended (the "1940 Act").

The Investment Advisers Act and the 1940 Act provide that each investment management contract under which our Affiliates manage assets for other parties either terminates automatically if assigned, or states that it is not assignable without consent. In general, the term "assignment" includes not only direct assignments, but also indirect assignments which may be deemed to occur upon the direct or indirect transfer of a "controlling block" of our voting securities or the voting securities of one of our Affiliates. The 1940 Act further provides that all investment contracts with mutual fund clients are subject to annual approval by the fund's board of directors, and may be terminated by such clients, without penalty, upon no later than 60 days notice.

Certain of our Affiliates are registered as broker-dealers with the Financial Industry Regulatory Authority ("FINRA"). Our Affiliates may also be subject to regulation under various other federal laws, as well as the securities and fiduciary laws of various states, and certain self regulatory organizations, depending on the nature of business activities.

#### ***Regulation Outside the United States***

Our affiliated investment management firms are also subject to the laws of other non-U.S. jurisdictions and non-U.S. regulatory agencies depending on the nature and scope of business activities or place of business in the various jurisdictions (including serving as advisors to public and privately offered funds which are organized under non-U.S. jurisdictions). Regulatory agencies outside of the U.S. have broad and varied supervisory and disciplinary powers, including, among other things, to require licensing and authorization to carry on a regulated business, or to require licensing or registration of individual employees, and may require the adoption or implementation of certain compliance policies and requirements, operational procedures and disclosures. Regulators may also impose restrictions on the manner and scope of an Affiliate's ability to do business in the particular jurisdiction. Regulations imposed by one jurisdiction may be different than those imposed by the U.S., or another jurisdiction.

#### **Employees and Corporate Organization**

As of December 31, 2007, we employed approximately 80 persons and our Affiliates employed approximately 1,500 persons, the substantial majority of which 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.

#### **Corporate Liability and Insurance**

Our Affiliates' operations entail the inherent risk of liability related to litigation from clients and actions taken by regulatory agencies. In addition, we face liability both directly as a control person of our Affiliates, and indirectly as a general partner or manager member of certain of our Affiliates. To protect our overall operations from such liability, we maintain errors and omissions and general liability insurance in amounts which we and our Affiliates consider appropriate. There can be no assurance, however, that a claim or claims will not exceed the limits of available insurance coverage, that any insurer will remain solvent and will meet its obligations to provide coverage, or that such coverage will continue to be available with sufficient limits or at a reasonable cost. A judgment against one of our Affiliates in excess of available coverage could have a material adverse effect on us.

## **Our Web Site**

Our web site is [www.amg.com](http://www.amg.com). It provides information about us, as well as a link in the "Investor Information" section of our web site to another web site where you can obtain, free of charge, a copy of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, including exhibits, and any amendments to those reports filed or furnished with the Securities and Exchange Commission pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended. We make these reports available through our web site as soon as reasonably practicable after our electronic filing of such materials with, or the furnishing of them to, the Securities and Exchange Commission. The information contained or incorporated on our web site is not a part of this Annual Report on Form 10-K.

## **Item 1A. Risk Factors**

We face a variety of risk factors that are substantial and inherent in our business, including market, liquidity, credit, operational, legal and regulatory risks. The following are some of the more important factors that could affect our business.

### ***Our financial results depend on equity market returns and the investment performance of our Affiliates.***

The investment management contracts of our Affiliates typically provide for payment based on the market value of assets under management, and payments will be adversely affected by declines in the equity markets. In addition, certain of our Affiliates' investment management contracts include fees based on investment performance relative to a specified benchmark and, as such, are directly dependent upon investment results which may vary substantially from year to year. Unfavorable market performance and volatility in the capital markets or in the prices of specific securities may reduce our Affiliates' assets under management, which in turn may adversely affect the fees payable to our Affiliates and, ultimately, our consolidated results of operations and financial condition.

### ***Our growth strategy depends upon continued growth from our existing Affiliates or upon our making new investments in boutique investment management firms.***

Our Affiliates may not be able to maintain their respective levels of performance or contribute to our growth at their historical levels or at currently anticipated levels. Also, our Affiliates may be unable to carry out their management succession plans, which may adversely affect their operations and revenue streams.

The success of our investment program will depend upon our ability to find suitable firms in which to invest and our ability to negotiate agreements with such firms on acceptable terms. We cannot be certain that we will be successful in finding or investing in such firms or that they will have favorable operating results following our investment, which could have an adverse effect on our business, financial condition and results of operations.

### ***Historically, equity markets and our common stock have been volatile.***

The market price of our common stock historically has experienced and may continue to experience volatility, and the broader equity markets have experienced and may again experience significant price and volume fluctuations. This volatility has affected the market prices of securities issued by many companies for reasons unrelated to their operating performance and may adversely affect the price of our common stock. In addition, our announcements of our quarterly operating results, changes in general conditions in the economy or the financial markets and other developments affecting us, our Affiliates or our competitors could cause the market price of our common stock to fluctuate substantially.

***Our Affiliates' businesses are highly regulated.***

Many aspects of our Affiliates' businesses are subject to extensive regulation by various U.S. federal regulatory authorities, certain state regulatory authorities and non-U.S. regulatory authorities. We cannot ensure that our Affiliates will fulfill all applicable regulatory requirements. If we or any of our Affiliates were to be named as a subject of an investigation or other regulatory action, the public announcement and potential publicity surrounding any such investigation or action could have a material adverse effect on our stock price and financial condition even if we (or our Affiliates) were found not to have committed any violation of the securities laws or other misconduct. The failure of any Affiliate to satisfy regulatory requirements could subject that Affiliate to sanctions that might materially impact the Affiliate's business and our business. Moreover, any changes in laws or regulatory requirements, or the interpretation or application of such laws and regulatory requirements by regulatory authorities, could have a material adverse impact on our profitability and mode of operations.

***Our international operations are subject to foreign risks, including political, regulatory, economic and currency risks.***

We and some of our Affiliates operate offices or advise clients outside of the United States, and several affiliated investment management firms, are based outside the United States. Accordingly, we and our current and any prospective affiliated investment management firms that have foreign operations are subject to risks inherent in doing business internationally, in addition to the risks our business faces more generally. These risks may include changes in applicable laws and regulatory requirements, difficulties in staffing and managing foreign operations, longer payment cycles, difficulties in collecting investment advisory fees receivable, different, and in some cases, less stringent legal, regulatory and accounting regimes, political instability, fluctuations in currency exchange rates, expatriation controls, expropriation risks and potential adverse tax consequences. These or other foreign risks may have an adverse effect both on our Affiliates and on our consolidated business, financial condition and results of operations.

***Our Affiliates' autonomy limits our ability to alter their management practices and policies, and we may be held responsible for liabilities incurred by them.***

Although our agreements with our Affiliates typically give us the authority to control and/or vote with respect to certain of their business activities, we generally are not directly involved in managing our Affiliates' day-to-day activities, including investment management policies and procedures, fee levels, marketing and product development, client relationships, employment and compensation programs and compliance activities. As a consequence, our financial condition and results of operations may be adversely affected by problems stemming from the day-to-day operations of our Affiliates.

Some of our Affiliates are partnerships or limited liability companies of which we are, or an entity controlled by us is, the general partner or manager member. Consequently, to the extent that any of these Affiliates incur liabilities or expenses that exceed its ability to pay for them, we may be directly or indirectly liable for their payment. In addition, with respect to each of our Affiliates, we may be held liable in some circumstances as a control person for the acts of the Affiliate or its employees. While we and our Affiliates maintain errors and omissions and general liability insurance in amounts believed to be adequate to cover certain potential liabilities, we cannot be certain that we will not have claims that exceed the limits of available insurance coverage, that the insurers will remain solvent and will meet their obligations to provide coverage or that insurance coverage will continue to be available to us and our Affiliates with sufficient limits and at a reasonable cost. A judgment against any of our Affiliates and/or us in excess of available insurance coverage could have a material adverse effect on the Affiliate and/or us.



***The failure to receive regular distributions from our Affiliates would adversely affect us, and our structure results in substantial structural subordination that may affect our ability to make payments on our obligations.***

We receive cash distributions from our Affiliates. An Affiliate's payment of distributions to us may be subject to claims by the Affiliate's creditors and to limitations applicable to the Affiliate under federal and state laws, including securities and bankruptcy laws, and any applicable non-U.S. laws. Additionally, an Affiliate may default on some or all of the distributions that are payable to us. As a result, we cannot guarantee that we will always receive these distributions from our Affiliates. The failure to receive the distributions to which we are entitled under our agreements with our Affiliates would adversely affect us, and may affect our ability to make payments on our obligations.

Our right to receive any assets of our Affiliates or subsidiaries upon their liquidation or reorganization, and thus the right of the holders of securities issued by us to participate in those assets, typically would be subordinated to the claims of that entity's creditors. In addition, even if we were a creditor of any of our Affiliates or subsidiaries, our rights as a creditor would be subordinate to any security interest and indebtedness that is senior to us.

***The agreed-upon expense allocation under our revenue sharing arrangements with our Affiliates may not be large enough to pay for all of the respective Affiliate's operating expenses.***

Our Affiliates have generally entered into agreements with us under which they have agreed to pay us a specified percentage of their respective gross revenue, while retaining a percentage of revenue for use in paying that Affiliate's operating expenses. We may not anticipate and reflect in those agreements possible changes in the revenue and expense base of any Affiliate, and the agreed-upon expense allocation may not be large enough to pay for all of an Affiliate's operating expenses. We may elect to defer the receipt of our share of an Affiliate's revenue to permit the Affiliate to fund such operating expenses, or we may restructure our relationship with an Affiliate with the aim of maximizing the long-term benefits to us, but we cannot be certain that any such deferral or restructured relationship would be of any greater benefit to us. Such a deferral or restructured relationship might have an adverse effect on our near-term or long-term profitability and financial condition.

***The sale or issue of substantial amounts of our common stock could adversely impact the price of our common stock.***

The sale of substantial amounts of our common stock in the public market could adversely impact its price. In connection with our financing activities, we issued securities that are convertible into shares of our common stock either upon the occurrence of certain events or, in the case of our mandatory convertible securities, upon the passage of time. The number of shares of our common stock to be issued will primarily be determined by the price of our common stock at the time of conversion or settlement of an underlying forward equity purchase contract. Upon the conversion of the securities, and especially if we were required to issue the maximum number of shares of common stock issuable under our outstanding convertible securities, a significant number of additional shares of our common stock would be sold in the public market. In the first quarter of 2008, an aggregate of approximately 11.0 million shares of common stock will be issued to the holders of our mandatory convertible securities and floating rate convertible securities; approximately 6.0 million shares remain issuable under the terms of our convertible securities. Moreover, in connection with future financing activities, we may issue additional convertible securities or shares of our common stock. Also, as of December 31, 2007, options to purchase approximately 5.0 million shares of our common stock were exercisable. Consequently, any such issuance of shares of our common stock could have the effect of substantially diluting the interests of our current equity holders. In the event that a large number of shares of our common stock are sold in the public market, the price of our common stock may fall.

***The failure to consummate announced investments in new investment management firms could have an adverse effect on our operating results and financial condition.***

Consummation of our acquisition transactions is generally subject to a number of closing conditions, contingencies and approvals, including but not limited to obtaining certain consents of the investment management firms' clients. In the event that an announced transaction is not consummated, we may experience a decline in the price of our common stock to the extent that the then-current market price reflects a market assumption that we will complete the announced transaction. In addition, the fact that a transaction did not close after we announced it publicly may negatively affect our ability and prospects to consummate transactions in the future. Finally, we must pay costs related to these transactions, including legal and accounting fees, even if the transactions are not completed, which may have an adverse effect on our results of operations and financial condition.

***We expect that we will need to raise additional capital in the future, and existing or future resources may not be available to us in sufficient amounts or on acceptable terms.***

While we believe that our existing cash resources and cash flow from operations will be sufficient to meet our working capital needs for normal operations for the foreseeable future, our continuing acquisitions of interests in new affiliated investment management firms will require additional capital. We may also need to repurchase some or all of our outstanding zero coupon senior convertible notes, we are contingently liable to make additional purchase payments upon the achievement of specified financial targets in connection with certain of our prior acquisitions and we have obligations to purchase additional equity in existing Affiliates, which obligations may be triggered from time to time. These obligations may require more cash than is then available from operations. Thus, we may need to raise capital by making additional borrowings or by selling shares of our common stock or other equity or debt securities, or to otherwise refinance a portion of these obligations. These financing activities could increase our interest expense, decrease our net income and dilute the interests of our existing stockholders. Moreover, we may not be able to obtain such financing on acceptable terms, if at all.

***Repurchase Obligations under Zero Coupon Senior Convertible Notes.*** In May 2001, we issued \$251 million aggregate principal amount at maturity of zero coupon senior convertible notes due 2021. As of December 31, 2007, \$83.5 million principal amount at maturity of zero coupon convertible notes remains outstanding. In May 2011 and 2016, the remaining holders may require us to repurchase all or a portion of the outstanding zero coupon senior convertible notes at their accreted value.

***Senior Credit Facility.*** We entered into an amended and restated senior credit facility in November 2007, which allows us to borrow up to \$950 million. Subject to the agreement of the lenders to increase their commitments, we have the option to borrow up to an aggregate of \$1.2 billion under this facility. We have used our credit facility in the past, and we may do so again in the future, to fund investments in new and existing Affiliates, refinance other indebtedness, repurchase stock and fund working capital. As of December 31, 2007, we had \$519.5 million outstanding under our credit facility.

Our credit facility will mature in February 2012. While we intend to obtain a new credit facility prior to that time, we may not be able to obtain financing on terms comparable to our current credit facility. Our failure to do so could increase our interest expense, decrease our net income and adversely affect our ability to fund new investments and otherwise use our credit facility as described above. We may borrow under our credit facility only if we continue to meet certain financial tests, including interest and leverage ratios. In addition, our credit facility contains provisions for the benefit of our lenders that restrict the manner in which we can conduct our business, that may adversely affect our ability to make investments in new and existing Affiliates and that may have an adverse impact on the interests of our stockholders. Because indebtedness under our credit facility bears interest at variable rates, in the event we have indebtedness outstanding under our credit facility, increases in interest rates may increase our interest expense, which could adversely affect our cash flow, our ability to meet our

debt service obligations and our ability to fund future investments. Although from time to time we are party to interest rate hedging contracts designed to offset a portion of our exposure to interest rate fluctuations, we cannot be certain that this strategy will be effective.

*Contingent Purchase Payments.* In connection with our investments in certain of our Affiliates, we are contingently liable, upon achievement of specified financial targets, to make additional purchase payments of up to \$232 million through 2011.

*Purchase of Additional Equity in Our Affiliates.* Many of our agreements provide Affiliate managers a conditional right that enables them to require us to purchase additional ownership interests in our Affiliates in certain circumstances and from time to time. We may pay for these purchases in cash, shares of our common stock or other forms of consideration. In connection with these purchases, we may face the financing risks described above.

***We have substantial intangibles on our balance sheet, and any impairment of our intangibles could adversely affect our results of operations and financial position.***

At December 31, 2007, our total assets were approximately \$3.4 billion, of which approximately \$1.7 billion were intangible assets, and approximately \$0.8 billion were equity investments in Affiliates, an amount comprised primarily of intangible assets. We cannot be certain that we will ever realize the value of such intangible assets. Acquired client relationships with definite lives are being amortized, or written off, over a weighted average period of 12 years. If we were to record an impairment charge related to these intangible assets or an other than temporary decline in the value of our equity investments, our results of operations and financial position could be adversely affected.

***We and our Affiliates rely on certain key personnel and cannot guarantee their continued service.***

We depend on the efforts of our executive officers and our other officers and employees. Our executive officers, in particular, play an important role in the stability and growth of our existing Affiliates and in identifying potential investment opportunities for us. We do not have employment agreements with our officers, although each of them has a significant equity interest, including stock options.

In addition, our Affiliates depend heavily on the services of key principals, who in many cases have managed their firms for many years. These principals often are primarily responsible for their firm's investment decisions. Although we use a combination of economic incentives, transfer restrictions and, in some instances, non-solicitation agreements and employment agreements in an effort to retain key management personnel, there is no guarantee that these principals will remain with their firms. Moreover, since certain Affiliates contribute significantly to our revenue, the loss of key management personnel at these Affiliates could have a disproportionate adverse impact on our business.

The loss of key management personnel or an inability to attract, retain and motivate sufficient numbers of qualified management personnel may adversely affect our business and our Affiliates' businesses. The market for investment managers is extremely competitive and is increasingly characterized by the frequent movement of investment managers among different firms. In addition, since individual investment managers at our Affiliates often maintain a strong, personal relationship with their clients that is based on their clients' trust in the manager, the departure of a manager could cause the Affiliate to lose client accounts, which could have a material adverse effect on the results of operations and financial condition of both the Affiliate and us.

***Our Affiliates' investment management contracts are subject to termination on short notice.***

Our Affiliates derive almost all of their revenue from their clients based upon their investment management contracts with those clients. These contracts are typically terminable by the client without

penalty upon relatively short notice (typically not longer than 60 days). We cannot be certain that our Affiliates will be able to retain their existing clients or to attract new clients. If our Affiliates' clients withdraw a substantial amount of funds, it is likely to harm our results.

***Our industry is highly competitive.***

Through our Affiliates, we compete with a broad range of investment managers, including public and private investment advisors, firms associated with securities broker-dealers, financial institutions, insurance companies, private equity firms, sovereign wealth funds and other entities that serve our three principal distribution channels, many of whom have greater resources. This competition may reduce the fees that our Affiliates can obtain for their services. We believe that our Affiliates' ability to compete effectively with other firms in our three distribution channels depends upon our Affiliates' products, investment performance and client-servicing capabilities, and the marketing and distribution of their investment products. Our Affiliates may not compare favorably with their competitors in any or all of these categories. From time to time, our Affiliates also compete with each other for clients.

The market for acquisitions of interests in investment management firms is highly competitive. Many other public and private financial services companies, including commercial and investment banks, insurance companies and investment management firms, which may have significantly greater resources than we do, also invest in or buy investment management firms. We cannot guarantee that we will be able to compete effectively with such companies, that new competitors will not enter the market or that such competition will not make it more difficult or not feasible for us to make new investments in investment management firms.

**Item 1B. Unresolved Staff Comments**

There are no unresolved written comments that were received from the Securities and Exchange Commission staff 180 days or more before the end of our fiscal year relating to our periodic or current reports under the Securities Exchange Act of 1934, as amended.

**Item 2. Properties**

Our headquarters and principal offices are located at 600 Hale Street, Prides Crossing, Massachusetts 01965; we believe that the property is suitable for the foreseeable future. In connection with our international initiatives, we have offices in Sydney, Australia; London, England; and Toronto, Canada. In addition, each of our Affiliates leases office space in the city or cities in which it conducts business.

**Item 3. Legal Proceedings**

From time to time, we and our Affiliates may be parties to various claims, suits and complaints. Currently, there are no such claims, suits or complaints that, in our opinion, would have a material adverse effect on our financial position, liquidity or results of operations.

**Item 4. Submission of Matters to a Vote of Security Holders**

No matters were submitted to a vote of stockholders during the fourth quarter of the year covered by this Annual Report on Form 10-K.

## PART II

**Item 5. 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, 2006 for the periods indicated.

	<u>High</u>	<u>Low</u>
<u>2006</u>		
First Quarter	\$ 108.58	\$ 79.58
Second Quarter	107.46	81.56
Third Quarter	101.81	84.00
Fourth Quarter	105.97	92.09
<u>2007</u>		
First Quarter	\$ 119.78	\$ 103.00
Second Quarter	131.84	106.70
Third Quarter	135.02	98.67
Fourth Quarter	136.51	114.15

The closing price for a share of our common stock as reported on the New York Stock Exchange composite tape on February 26, 2008 was \$98.88. As of February 26, 2008, there were 39 stockholders of record.

We have not declared a cash dividend with respect to the periods presented. We do not anticipate paying cash dividends on our common stock as 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. Furthermore, our credit facility prohibits us from making cash dividend payments to our stockholders.

**Issuer Purchases of Equity Securities**

<u>Period</u>	<u>Total Number of Shares Purchased<sup>(1)</sup></u>	<u>Average Price Paid Per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs<sup>(2)</sup></u>	<u>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs<sup>(3)</sup></u>
October 1 31, 2007	1,673,300	\$ 130.66	95,000	1,995,106
November 1 30, 2007	115,000	\$ 126.31	115,000	1,880,106
December 1 31, 2007	42,005	\$ 92.15		1,880,106
Total	1,830,305	\$ 129.50	210,000	1,880,106

- (1) In October 2007, we agreed to purchase 1,578,300 shares of our common stock pursuant to a prepaid forward purchase contract which we may elect to settle at any time on or before October 15, 2012. In December 2007, we received 42,005 shares of common stock upon the settlement of certain of our call spread option agreements.
- (2) Notes 19 and 21 to the Consolidated Financial Statements provide additional detail with respect to our share repurchase programs.
- (3) As of February 26, 2008, there were 1,780,106 shares that could be purchased under our share repurchase programs.

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**Item 6. Selected 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 Consolidated Financial Statements and accompanying notes included elsewhere in this Annual Report on Form 10-K.

For the Years Ended December 31,

	2003	2004	2005	2006	2007
<i>(in thousands, except as indicated and per share data)</i>					
<b>Statement of Income Data</b>					
Revenue	\$ 495,029	\$ 659,997	\$ 916,492	\$ 1,170,353	\$ 1,369,866
Net Income	60,528	77,147	119,069	151,277	181,961
Earnings per share diluted	1.57	2.02	2.81	3.74	4.58
Average shares outstanding diluted	40,113	39,645	44,690	45,159	44,922
<b>Other Financial Data</b>					
Assets under Management (at period end, in millions)	\$ 91,524	\$ 129,802	\$ 184,310	\$ 241,140	\$ 274,764
Cash Flow from (used in):					
Operating activities	\$ 116,515	\$ 177,886	\$ 204,078	\$ 301,003	\$ 326,654
Investing activities	(73,882)	(478,266)	(82,029)	(165,079)	(580,755)
Financing activities	153,697	215,243	(122,267)	(75,082)	272,548
EBITDA <sup>(1)</sup>	147,215	186,434	267,463	342,118	418,229
Cash Net Income <sup>(2)</sup>	104,944	126,475	186,103	222,454	258,749
<b>Balance Sheet Data</b>					
Total assets <sup>(3)</sup>	\$ 1,519,205	\$ 1,933,421	\$ 2,321,636	\$ 2,665,920	\$ 3,395,705
Intangible assets <sup>(3)</sup>	1,116,036	1,328,976	1,576,941	1,679,293	1,726,989
Equity investments in Affiliates <sup>(3)</sup>		252,597	301,476	293,440	842,490
Affiliate investments in partnerships <sup>(4)</sup>	2,303	4,594	5,079	108,350	134,657
Minority interest in Affiliate investments in partnerships <sup>(4)</sup>				104,096	127,397
Senior debt <sup>(5)</sup>		126,750	241,250	365,500	519,500
Senior convertible securities <sup>(6)</sup>	423,340	423,958	424,232	413,358	378,083
Mandatory convertible securities	230,000	300,000	300,000	300,000	300,000
Junior convertible trust preferred securities <sup>(7)</sup>				300,000	800,000
Other long-term obligations <sup>(8)</sup>	108,851	155,565	202,772	229,793	290,538
Stockholders' equity <sup>(9)</sup>	614,769	707,692	817,381	499,222	469,202

(1) The definition of EBITDA is presented in Note 4 on page 2. 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."

(2) 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."

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- (3) Total assets, Intangible assets and Equity investments in Affiliates have increased as we have made new or additional investments in affiliated investment management firms.
- (4) In 2006, we implemented Emerging Issues Task Force Issue 04-05, "EITF 04-05" (see Note 1 to the Consolidated Financial Statements). In accordance with EITF 04-05, we have consolidated client assets held in partnerships controlled by our Affiliates. These assets are reported as "Affiliate investments in partnerships;" a majority of these assets are held by investors that are unrelated to us, and are reported as "Minority interest in Affiliate investments in partnerships."
- (5) Senior debt consists of outstanding borrowings under our senior credit facility and, through November 2006, our senior notes due 2006.
- (6) Senior convertible securities consists of our zero coupon senior convertible notes and our floating rate senior convertible securities.
- (7) In 2006 and 2007, we completed private placements of junior convertible trust preferred securities of \$300 million and \$500 million, respectively.
- (8) Other long-term obligations consist principally of income taxes and payables to related parties.
- (9) During 2006 and 2007, we repurchased \$537,777 and \$426,479 of our common stock, respectively, including \$206,394 pursuant to the prepaid forward purchase contract described on page 33.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Forward-Looking Statements**

*When used in this Annual Report on Form 10-K and in our other filings with the United States 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 global 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, that we will be able to consummate announced investments in new investment management firms, 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 "Risk Factors."

*These factors (as well as those discussed above under "Risk Factors") 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 boutique investment management firms (our "Affiliates"). We pursue a growth strategy designed to generate shareholder value through the internal growth of our existing business, additional investments in boutique investment management firms and strategic transactions and relationships designed to enhance our Affiliates' businesses and growth prospects.

Through our Affiliates, we manage approximately \$274.8 billion in assets (as of December 31, 2007) in more than 300 investment products across a broad range of asset classes and investment styles in three principal distribution channels: Mutual Fund, Institutional and High Net Worth. 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 100 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.



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In the Institutional distribution channel, our Affiliates offer approximately 200 investment products across approximately 50 different investment styles, including small, small/mid, mid and large capitalization value, growth equity and emerging markets. In addition, our Affiliates offer quantitative, alternative, credit arbitrage 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 high net worth 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 and wrap programs.

In 2007, we enhanced the diversity of our product offerings across these channels through investments in two alternative investment managers:

In November, we acquired a minority interest in ValueAct Capital ("ValueAct"), a San Francisco-based investment firm that establishes ownership interests in undervalued companies and works with each company's management and Board of Directors to implement business strategies that enhance shareholder value. ValueAct has over 250 clients, including endowments, foundations, corporations, family offices, high net worth investors and funds of funds.

In December 2007, we acquired a minority interest in BlueMountain Capital Management ("BlueMountain"), a leading global credit alternatives manager specializing in relative value strategies in the corporate loan, bond, credit and equity derivatives markets. BlueMountain has offices in New York and London, and manages assets on behalf of predominantly institutional and high net worth clients.

We operate our business through our Affiliates in our three principal distribution channels, maintaining each Affiliate's distinct entrepreneurial culture and independence through our investment structure. In each case, our Affiliates are organized as separate firms, and their operating or shareholder agreements are tailored to provide appropriate incentives for our Affiliate management owners and to address the particular characteristics of that Affiliate while enabling us to protect our interests.

In making investments in boutique asset management firms, we seek to partner with the highest quality firms in the industry, with outstanding management teams, strong long-term performance records and a demonstrated commitment to continued growth and success. Fundamental to our investment approach is the belief that Affiliate management equity ownership (along with AMG's ownership) aligns our interests and provides Affiliate managers with a powerful incentive to continue to grow their business. Our investment structure provides a degree of liquidity and diversification to principal owners of boutique investment management firms, while at the same time expanding equity ownership opportunities among the firm's management and allowing management to continue to participate in the firm's future growth. Our partnership approach also ensures that Affiliates maintain operational autonomy in managing their business, thereby preserving their firm's entrepreneurial culture and independence.

Although the specific structure of each investment is highly tailored to meet the needs of a particular Affiliate, in all cases, AMG establishes a meaningful equity interest in the firm, with the remaining equity interests retained by the management of the Affiliate. Each Affiliate is organized as a

separate firm, and its operating or shareholder agreement is structured to provide appropriate incentives for Affiliate management owners and to address the Affiliate's particular characteristics while also enabling us to protect our interests, including through arrangements such as long-term employment agreements with key members of the firm's management team.

In most cases, we own a majority of the equity interests of a firm and structure a revenue sharing arrangement, in which a percentage of revenue 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.

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 both the Operating Allocation and the Owners' Allocation. These arrangements also provide incentives to control operating expenses, thereby increasing the portion of the Operating Allocation that is available for growth initiatives and compensation.

An Affiliate's Operating Allocation is structured to cover its operating expenses. However, should actual operating expenses exceed the Operating Allocation, our contractual share of cash under the Owners' Allocation generally has priority over the allocations and distributions to the Affiliate's managers. As a result, the excess expenses first reduce the portion of the Owners' Allocation allocated to the Affiliate's managers until that portion is eliminated, before reducing 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.

Our minority investments are also structured to align our interests with those of the Affiliate's management through shared equity ownership, as well as to preserve the Affiliate's entrepreneurial culture and independence by maintaining the Affiliate's operational autonomy. In cases where we hold a minority interest, the revenue sharing arrangement generally allocates a percentage of the Affiliate's revenue. The remaining revenue is used to pay operating expenses and profit distributions to the other owners.

Certain of our Affiliates operate under profit-based arrangements through which we own a majority of the equity in the firm and receive a share of profits as cash flow, rather than a percentage of revenue through a typical revenue sharing agreement. As a result, we participate fully in any increase or decrease in the revenue or expenses of such firms. In these cases, we participate in a budgeting process and generally provide incentives to management through compensation arrangements based on the performance of the Affiliate.

We are focused on establishing and maintaining long-term partnerships with our Affiliates. Our shared equity ownership gives both AMG and our Affiliate partners meaningful incentives to manage their businesses for strong future growth. From time to time, we may consider changes to the structure of our relationship with an Affiliate in order to better support the firm's growth strategy.

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; 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"). 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 but may reflect changes due to client withdrawals. Conversely, advisory fees billed in arrears will reflect changes in the market value of assets under management for that period.

In addition, over 50 Affiliate alternative investment and equity products, representing approximately \$45 billion of assets under management (as of December 31, 2007), also bill on the basis of absolute or relative investment performance ("performance fees"). These products, which are primarily in the Institutional distribution channel, are often structured to have returns that are not directly correlated to changes in broader equity indices and, if earned, the performance fee component is typically billed less frequently than an asset-based fee. Although performance fees inherently depend on investment results and will vary from period to period, we anticipate performance fees to be a recurring component of our revenue. We also anticipate that, within any calendar year, the majority of performance fees will typically be realized in the fourth quarter.

For certain of our Affiliates, generally where we own a minority interest, we are required to use the equity method of accounting. Consistent with this method, we have not consolidated the operating results of these firms (including their revenue) in our Consolidated Statements of Income. Our share of these firms' profits (net of intangible amortization) is reported in "Income from equity method investments," and is therefore reflected in our Net Income and EBITDA. As a consequence, increases or decreases in these firms' assets under management (which totaled \$64.0 billion as of December 31, 2007) will not affect reported revenue in the same manner as changes in assets under management at our other Affiliates. Our recent investments in ValueAct and BlueMountain are both accounted for under the equity method of accounting.

Our Net Income reflects the revenue of our consolidated Affiliates and our share of income from Affiliates which we account for under the equity method, reduced by:

our expenses, including the operating expenses of our consolidated Affiliates; and

the profits allocated to managers of our consolidated Affiliates (i.e., minority interest).

As discussed above, for consolidated 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 consolidated 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 global 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;

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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 our expenses, including compensation for our employees; and

the level of taxation to which we are subject.

### 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 on Form 10-K).

#### Assets under Management

Statement of Changes	Mutual Fund	Institutional	High Net Worth	Total
<i>(in billions)</i>				
December 31, 2004	\$ 33.9	\$ 76.1	\$ 19.8	\$ 129.8
Net client cash flows	4.1	8.7	(2.0)	10.8
New investments <sup>(1)</sup>	6.9	15.0	6.1	28.0
Investment performance	5.4	13.1	0.8	19.3
Other <sup>(2)</sup>		(3.6)		(3.6)
December 31, 2005	50.3	109.3	24.7	184.3
Net client cash flows	0.4	18.5	0.5	19.4
New investments <sup>(1)</sup>	0.6	11.1	0.2	11.9
Investment performance	6.9	16.1	3.4	26.4
Other <sup>(2)</sup>		(0.3)	(0.6)	(0.9)
December 31, 2006	58.2	154.7	28.2	241.1
Net client cash flows	(0.2)	0.7	(0.9)	(0.4)
New investments <sup>(1)</sup>		8.8	2.0	10.8
Investment performance	4.6	15.9	3.9	24.4
Other <sup>(2)</sup>	(0.4)	0.3	(1.0)	(1.1)
December 31, 2007	\$ 62.2	\$ 180.4	\$ 32.2	\$ 274.8

(1)

In 2005, we acquired the mutual fund business of Fremont Investment Advisors Inc. through Managers Investment Group LLC and completed new Affiliate investments in a group of Canadian asset management firms. In 2006, we completed a new Affiliate investment in Chicago Equity Partners. In 2007, we completed new investments in ValueAct and BlueMountain.

(2)

We transferred our interests in certain affiliated investment management firms in each of the periods presented. Additionally, during 2007, we reclassified \$0.6 billion and \$0.4 billion of existing assets under management to the Mutual Fund and Institutional

distribution channels, respectively, from the High Net Worth distribution channel. These changes were not material to our financial position or results of operations.

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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 generally represent 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.

	<u>2005</u>	<u>2006</u>	<u>% Change</u>	<u>2007</u>	<u>% Change</u>
<i>(in millions, except as noted)</i>					
<b>Average Assets under Management (in billions)<sup>(1)</sup></b>					
Mutual Fund	\$ 43.0	\$ 54.4	27%	\$ 61.9	14%
Institutional	88.8	125.1	41%	168.9	35%
High Net Worth	20.9	26.8	28%	30.5	14%
	<u>          </u>	<u>          </u>		<u>          </u>	
Total	\$ 152.7	\$ 206.3	35%	\$ 261.3	27%
	<u>          </u>	<u>          </u>		<u>          </u>	
<b>Revenue<sup>(2)(3)</sup></b>					
Mutual Fund	\$ 400.9	\$ 501.7	25%	\$ 558.3	11%
Institutional	385.7	514.8	33%	645.6	25%
High Net Worth	129.9	153.9	18%	166.0	8%
	<u>          </u>	<u>          </u>		<u>          </u>	
Total	\$ 916.5	\$ 1,170.4	28%	\$ 1,369.9	17%
	<u>          </u>	<u>          </u>		<u>          </u>	
<b>Net Income<sup>(2)</sup></b>					
Mutual Fund	\$ 56.8	\$ 68.0	20%	\$ 72.5	7%
Institutional	51.3	65.8	28%	87.9	34%
High Net Worth	11.0	17.5	59%	21.6	23%
	<u>          </u>	<u>          </u>		<u>          </u>	
Total	\$ 119.1	\$ 151.3	27%	\$ 182.0	20%
	<u>          </u>	<u>          </u>		<u>          </u>	
<b>EBITDA<sup>(2)(3)</sup></b>					
Mutual Fund	\$ 110.3	\$ 138.2	25%	\$ 153.9	11%
Institutional	125.2	162.3	30%	211.3	30%
High Net Worth	32.0	41.6	30%	53.0	27%
	<u>          </u>	<u>          </u>		<u>          </u>	
Total	\$ 267.5	\$ 342.1	28%	\$ 418.2	22%
	<u>          </u>	<u>          </u>		<u>          </u>	

(1) Assets under management attributable to investments that were completed 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 \$20.6 billion, \$39.1 billion and \$53.7 billion for 2005, 2006 and 2007, respectively.

(2) Note 26 to the Consolidated Financial Statements describes the basis of presentation of the financial results of our three operating segments. As discussed in Note 1 to the Consolidated Financial Statements, we are required to use the equity method of accounting for certain investments and as such do not consolidate their revenue for financial reporting purposes. Our share of profits from these investments is reported in "Income from equity method investments" and is therefore reflected in Net Income and EBITDA.

(3) The definition of EBITDA and our reasons for using EBITDA are presented in Note 4 on page 2. Our use of EBITDA, including a reconciliation to cash flow from operations, is discussed in greater detail in "Liquidity and Capital Resources."

**Revenue**

Our revenue is generally determined by the level of our assets under management, the portion of our assets across our products and three operating segments, which realize different fee rates, and the recognition of any performance fees.

Our revenue increased \$199.5 million (or 17%) in 2007 from 2006, primarily as a result of a 27% increase in average assets under management. The increase in average assets under management resulted principally from positive investment performance in 2006 and 2007, net client cash flows in 2006 and, to a lesser extent, our 2006 investment in a new Affiliate. The increase in revenue was proportionately less than the growth in assets under management primarily as a result of our equity method investments, as we do not consolidate the revenue or expenses of these Affiliates.

The increase in revenue of \$253.9 million (or 28%) in 2006 from 2005 resulted principally from a 35% increase in average assets under management. The increase in average assets under management was primarily attributable to positive investment performance and net client cash flows and, to a lesser extent, our 2005 investments in new Affiliates. The increase in revenue was proportionately less than the growth in assets under management primarily as a result of our equity method investments, as we do not consolidate the revenue or expenses of these Affiliates.

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

*Mutual Fund Distribution Channel*

The increase in revenue of \$56.6 million (or 11%) in the Mutual Fund distribution channel in 2007 from 2006 resulted principally from a 14% increase in average assets under management. The increase in average assets under management resulted principally from positive investment performance.

The increase in revenue of \$100.8 million (or 25%) in 2006 from 2005 resulted principally from a 27% increase in average assets under management. The increase in average assets under management resulted principally from positive investment performance, our 2005 investments in new Affiliates, and positive net client cash flows.

*Institutional Distribution Channel*

The increase in revenue of \$130.8 million (or 25%) in the Institutional distribution channel in 2007 from 2006 resulted principally from a 35% increase in average assets under management. The increase in average assets under management resulted principally from positive investment performance in 2006 and 2007, net client cash flows in 2006 and, to a lesser extent, our 2006 investment in a new Affiliate. The increase in revenue was proportionately less than the increase in assets under management primarily as a result of our equity method investments, as we do not consolidate revenue or expenses of such Affiliates.

Our revenue increased \$129.1 million (or 33%) in 2006 from 2005, primarily as a result of a 41% increase in average assets under management. The increase in average assets under management resulted principally from positive investment performance and net client cash flows and, to a lesser extent, our 2005 investments in new Affiliates. The increase in revenue was proportionately less than the increase in assets under management primarily as a result of our equity method investments, as we do not consolidate revenue or expenses of such Affiliates.

*High Net Worth Distribution Channel*

The increase in revenue of \$12.1 million (or 8%) in the High Net Worth distribution channel in 2007 from 2006 resulted principally from a 14% increase in average assets under management. The increase in average assets under management resulted principally from positive investment

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performance. The increase in revenue was proportionately less than the increase in assets under management primarily as a result of our equity method investments, as we do not consolidate the revenue or expenses of these Affiliates, and increases in assets under management that realize a comparatively lower fee rate.

Our revenue increased \$24.0 million (or 18%) in 2006 from 2005 primarily as a result of a 28% increase in average assets under management. The increase in average assets under management resulted principally from our 2005 investments in new Affiliates and positive investment performance. The increase in revenue was proportionately less than the increase in assets under management primarily as a result of our equity method investments, as we do not consolidate the revenue or expenses of these Affiliates, and increases in assets under management that realize a comparatively lower fee rate.

### Operating Expenses

The following table summarizes our consolidated operating expenses:

	<u>2005</u>	<u>2006</u>	<u>% Change</u>	<u>2007</u>	<u>% Change</u>
<i>(in millions)</i>					
Compensation and related expenses	\$ 365.9	\$ 472.4	29%	\$ 579.4	23%
Selling, general and administrative	162.1	184.0	14%	198.0	8%
Amortization of intangible assets	24.9	27.4	10%	31.7	16%
Depreciation and other amortization	7.0	8.7	24%	10.4	20%
Other operating expenses	21.5	23.9	11%	18.8	(21)%
<b>Total operating expenses</b>	<b>\$ 581.4</b>	<b>\$ 716.4</b>	<b>23%</b>	<b>\$ 838.3</b>	<b>17%</b>

The substantial portion of our operating expenses is incurred by our Affiliates, the majority of which is incurred by Affiliates with revenue sharing arrangements. For Affiliates with revenue sharing arrangements, an Affiliate's Operating Allocation percentage generally determines its operating expenses. Accordingly, our compensation expense is generally impacted by increases or decreases in each Affiliate's revenue and the corresponding increases or decreases in their respective Operating Allocations. During 2007, approximately \$322.6 million, or about 56% of our consolidated compensation expense, was attributable to our Affiliate managers. The percentage of revenue allocated to operating expenses varies from one Affiliate to another and may vary within an Affiliate depending on the source or amount of revenue. As a result, changes in our aggregate revenue may not impact our consolidated operating expenses to the same degree.

Compensation and related expenses increased 23% in 2007 and 29% in 2006. These increases were 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 expense. The increases were also related to increases in aggregate Affiliate expenses from our new investments (\$13.4 million in 2007 and \$12.8 million in 2006). In 2007, the increase in compensation was proportionately greater than the increase in revenue because of an increase in revenue at Affiliates with higher Operating Allocations. Unrelated to the changes in revenue, the increase in 2007 was also attributable to a \$7.4 million increase in share-based compensation.

Selling, general and administrative expenses increased 8% in 2007 and 14% in 2006, principally as a result of the growth in assets under management at our Affiliates in the Mutual Fund distribution channel. Selling, general and administrative expenses also increased in 2007 as a result of \$1.0 million of expenses related to our global distribution initiatives. These increases were partially offset by a \$6.7 million decrease in aggregate Affiliate expenses from the transfer of our interests in certain Affiliates during 2006 and 2007.



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Amortization of intangible assets increased 16% in 2007 and 10% in 2006, principally from an increase in definite-lived intangible assets resulting from our investments in new and existing Affiliates during 2005 and 2006.

Depreciation and other amortization increased 20% in 2007 and 24% in 2006. These increases were principally attributable to spending on depreciable assets in recent periods. The increase in 2006 was also attributable to our 2005 investments in new Affiliates.

Other operating expenses decreased 21% in 2007 principally as a result of benefits realized upon the transfer of Affiliate interests during 2007 as well as a \$0.8 million recovery of Affiliate expenses that previously reduced our share of Owners' Allocation. These decreases were partially offset by a \$0.7 million increase in aggregate Affiliate expenses from our 2006 investment in Chicago Equity Partners. Other operating expenses increased 11% in 2006 principally as a result of a \$1.1 million increase in operating expenses from our new investments in 2005 and expenses related to other Affiliate transactions.

### **Other Income Statement Data**

The following table summarizes non-operating income and expense data:

	<u>2005</u>	<u>2006</u>	<u>% Change</u>	<u>2007</u>	<u>% Change</u>
<i>(in millions)</i>					
Income from equity method investments	\$ 27.0	\$ 38.3	42%	\$ 58.2	52%
Investment and other income	8.9	16.9	90%	17.1	1%
Investment income from Affiliate investments in partnerships	0.4	3.4	750%	38.9	1,044%
Minority interest in Affiliate investments in partnerships		3.4		38.1	1,021%
Minority interest	144.3	212.5	47%	242.0	14%
Interest expense	37.4	58.8	57%	76.9	31%
Income tax expense	70.6	86.6	23%	106.9	23%

Income from equity method investments consists of our share of income from Affiliates that are accounted for under the equity method of accounting, net of any related intangible amortization. Income from equity method investments increased 52% in 2007 and 42% in 2006 principally as a result of increases in assets under management and revenue attributable to Affiliates that are accounted for under the equity method of accounting, including investments in our new Affiliates.

Investment and other income primarily consists of earnings on cash and cash equivalent balances and earnings that Affiliates realize on investments in marketable securities. Investment and other income increased 1% in 2007 and 90% in 2006. The increase in 2006 resulted principally from an increase in Affiliate investment earnings of \$6.4 million, and earnings of \$1.6 million on investments held by new Affiliates.

As discussed in Note 1 to the Consolidated Financial Statements, Investment income from Affiliate investments in partnerships and Minority interest in Affiliate investments in partnerships relate to the consolidation of certain investment partnerships in which our Affiliates serve as the general partner. For 2007 and 2006, the income from Affiliate investments in partnerships was \$38.9 million and \$3.4 million, respectively, which was principally attributable to investors who are unrelated to us.

Minority interest increased 14% in 2007 and 47% in 2006, principally as a result of the previously discussed increases in revenue. In 2006, the increase was proportionately greater than the increase in revenue because certain Affiliates reported expenses that were less than their Operating Allocation, resulting in higher profits attributable to our Affiliate management partners. In 2007, these Affiliates reported expenses that were equal to their Operating Allocation.

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Interest expense increased 31% in 2007, principally from borrowings under our senior credit facility (\$11.5 million in 2007), the October 2007 issuance of \$500 million of junior convertible trust preferred securities (\$5.4 million in 2007) and the April 2006 issuance of \$300 million of junior convertible trust preferred securities (\$3.5 million in 2007). These increases were partially offset by a \$3.1 million decrease in interest expense from the repayment of our Senior Notes due 2006. The increase in 2006 was principally attributable to the \$300 million junior convertible trust preferred securities (\$11.4 million in 2006) and increases in borrowings under our senior credit facility (\$7.2 million in 2006).

Income taxes increased 23% in 2007 and 2006 principally as a result of the increases in net income before taxes of 21% and 25%, respectively. The increase in 2006 was partially offset by a \$1.4 million reduction in income taxes from a decrease in Canadian federal income tax rates, which reduction did not recur in 2007.

### **Net Income**

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

	<u>2005</u>	<u>2006</u>	<u>% Change</u>	<u>2007</u>	<u>% Change</u>
<i>(in millions)</i>					
Net Income	\$ 119.1	\$ 151.3	27%	\$ 182.0	20%

Net Income increased 20% in 2007 and 27% in 2006, principally as a result of increases in revenue and income from equity method investments, partially offset by increases in reported operating, interest, minority interest and tax expenses, as described above.

### **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.

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

	<u>2005</u>	<u>2006</u>	<u>2007</u>
<i>(in millions)</i>			
<b>Net Income</b>	\$ 119.1	\$ 151.3	\$ 182.0
Intangible amortization	24.9	27.4	31.6
Intangible amortization equity method investment <sup>(1)</sup>	8.5	9.3	10.4
Intangible-related deferred taxes	28.8	28.8	28.6
Affiliate depreciation	4.8	5.7	6.1
<b>Cash Net Income</b>	<b>\$ 186.1</b>	<b>\$ 222.5</b>	<b>\$ 258.7</b>

- (1) As discussed in Note 1 to the Consolidated Financial Statements, we are required to use the equity method of accounting for our investments in AQR, Beutel, Deans Knight, ValueAct and BlueMountain and, as such, do not consolidate their revenue or expenses (including intangible amortization expenses) in our income statement. Our share of these investments' amortization is reported in "Income from equity method investments."

Cash Net Income increased 16% in 2007 and 20% in 2006, primarily as a result of the previously described factors affecting Net Income.

### Liquidity and Capital Resources

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

	<u>December 31,</u>		
	<u>2005</u>	<u>2006</u>	<u>2007</u>
<i>(in millions)</i>			
<b>Balance Sheet Data</b>			
Cash and cash equivalents	\$ 140.4	\$ 201.7	\$ 223.0
Senior debt	241.3	365.5	519.5
Zero coupon convertible notes	124.2	113.4	78.1
Floating rate convertible securities	300.0	300.0	300.0
Mandatory convertible securities	300.0	300.0	300.0
Junior convertible trust preferred securities		300.0	800.0
<b>Cash Flow Data</b>			
Operating cash flows	\$ 204.1	\$ 301.0	\$ 326.7
Investing cash flows	(82.0)	(165.1)	(580.8)
Financing cash flows	(122.3)	(75.1)	272.5
<b>EBITDA<sup>(1)</sup></b>	<b>267.5</b>	<b>342.1</b>	<b>418.2</b>

- (1) The definition of EBITDA is presented in Note 4 on page 2.

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 securities or our junior convertible trust preferred securities as debt for the purpose of determining our leverage ratio. 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 credit facility is generally consistent with our treatment of our mandatory convertible securities and our junior convertible trust preferred securities and our net debt approach. As of December 31, 2007, our leverage ratio was 1.6:1.



**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:

	2005	2006	2007
<i>(in millions)</i>			
<b>Cash Flow from Operations</b>	\$ 204.1	\$ 301.0	\$ 326.7
Interest expense, net of non-cash items <sup>(1)</sup>	32.5	53.6	70.9
Current tax provision	38.9	55.2	74.6
Income from equity method investments, net of distributions <sup>(2)</sup>	18.9	1.6	15.0
Changes in assets and liabilities and other adjustments <sup>(3)</sup>	(26.9)	(69.3)	(69.0)
<b>EBITDA<sup>(4)</sup></b>	<b>\$ 267.5</b>	<b>\$ 342.1</b>	<b>\$ 418.2</b>

- (1) Non-cash items represent amortization of issuance costs and interest accretion (\$4.9, \$5.2 and \$6.0 million in 2005, 2006 and 2007, respectively).
- (2) Distributions from equity method investments were \$16.6, \$46.0 and \$53.6 million for 2005, 2006 and 2007, respectively.
- (3) Other adjustments include stock option expenses, tax benefits from stock options and other adjustments to reconcile Net Income to net cash flow from operating activities.
- (4) The definition of EBITDA is presented in Note 4 on page 2.

In 2007, we met our cash requirements primarily through cash generated by operating activities, the issuance of convertible securities and borrowings of senior debt. Our principal uses of cash were to repurchase shares of our common stock, make investments in new and existing Affiliates, repay senior debt 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 Credit Facility**

On November 27, 2007, we entered into an amended and restated senior credit facility (the "Facility"). The Facility allows us to borrow an aggregate of \$950 million. The Facility is comprised of a \$750 million revolving credit facility (the "Revolver") and a \$200 million term loan (the "Term Loan"). We pay interest on these obligations at specified rates (based either on the Eurodollar rate or the prime rate as in effect from time to time) that vary depending on our credit rating. The Term Loan requires principal payments to be made at specified dates until maturity. Subject to the agreement of lenders to provide additional commitments, we have the option to increase the Facility by up to an additional \$250 million.

The Facility will mature in February 2012, and contains financial covenants with respect to leverage and interest coverage. The Facility also contains customary affirmative and negative covenants,

including limitations on indebtedness, liens, cash dividends and fundamental corporate changes. Borrowings under the Facility are collateralized by pledges of the substantial majority of our capital stock or other equity interests owned by us. As of December 31, 2007, we had \$519.5 million outstanding under our Facility.

#### ***Zero Coupon Senior Convertible Notes***

In 2001, we issued \$251 million principal amount at maturity of zero coupon senior convertible notes due 2021 ("zero coupon convertible notes"), with each note issued at 90.50% of such principal amount and accreting at a rate of 0.50% per year. As of December 31, 2007, \$83.5 million principal amount at maturity remain outstanding. Each security is convertible into 17.429 shares of our common stock (at a current base conversion price of \$53.68) 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 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 at their accreted value. Under the terms of the indenture governing the zero coupon convertible notes, a holder may convert such security into common stock by following the conversion procedures in the indenture; subject to changes in the price of our common stock, the zero coupon convertible notes may not be convertible in certain future periods.

In 2006, we amended the zero coupon convertible notes. Under the terms of this amendment, we will pay interest through May 7, 2008 at a rate of 0.375% per year on the principal amount at maturity of the notes in addition to the accrual of the original issue discount.

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

In 2003, we issued \$300 million of floating rate senior convertible securities due 2033 ("floating rate convertible securities") bearing interest at a rate equal to 3-month LIBOR minus 0.50%, payable in cash quarterly. In the first quarter of 2008, we called the outstanding floating rate convertible securities for redemption at their principal amount plus accrued and unpaid interest. In lieu of redemption, substantially all of the holders elected to convert their securities. Pursuant to these conversions and other privately negotiated exchanges, we will issue approximately 7.0 million shares of common stock and all of our floating rate convertible securities will be cancelled and retired.

The floating rate senior convertible securities are considered contingent payment debt instruments under federal income tax regulations. These regulations required us to deduct interest in an amount greater than our reported interest expense, and resulted in annual deferred taxes of approximately \$3.7 million. Because the trading price of our common stock exceeded \$60.90 at the time of the conversions described above, \$18.3 million of deferred tax liabilities attributable to these securities will be reclassified to stockholders' equity in the first quarter of 2008.

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

In 2004, we issued \$300 million of mandatory convertible securities ("2004 PRIDES"), each unit consisting of (i) a senior note due February 2010 with a principal amount of \$1,000 per note, with interest payable quarterly at the annual rate of 4.125%, and (ii) a forward equity purchase contract pursuant to which the holder agreed to purchase shares of our common stock in February 2008. The holders' obligations under the forward equity purchase contracts were collateralized by the pledge to us of the senior notes.

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In the first quarter of 2008, we repurchased the outstanding senior notes component of our 2004 PRIDES. The repurchase proceeds were used by the original holders to fulfill their obligations under the related forward equity purchase contracts. Pursuant to the settlement of the forward equity purchase contracts and other privately negotiated exchanges, we have issued approximately 4.0 million shares of common stock. All of our 2004 PRIDES have been cancelled and retired.

### *Junior Convertible Trust Preferred Securities*

In 2006, we issued \$300 million of junior subordinated convertible debentures due 2036 to a wholly-owned trust simultaneous with the issuance, by the trust, of \$291 million of convertible trust preferred securities to investors. The junior subordinated convertible debentures and convertible trust preferred securities (together, the "2006 junior convertible trust preferred securities") have substantially the same terms.

The 2006 junior convertible trust preferred securities bear interest at 5.1% per annum, payable quarterly in cash. Each \$50 security is convertible, at any time, into 0.333 shares of our common stock, which represents a conversion price of \$150 per share (or a 48% premium to the then prevailing share price of \$101.45). Upon conversion, investors will receive cash or shares of our common stock (or a combination of cash and common stock) at our election. The 2006 junior convertible trust preferred securities may not be redeemed by us prior to April 15, 2011. On or after April 15, 2011, they may be redeemed if the closing price of our common stock exceeds \$195 per share for a specified period of time. The trust's only assets are the junior convertible subordinated debentures. To the extent that the trust has available funds, we are obligated to ensure that holders of the 2006 junior convertible trust preferred securities receive all payments due from the trust.

In October 2007, we issued an additional \$500 million of junior subordinated convertible debentures due 2037 to a wholly-owned trust simultaneous with the issuance, by the trust, of \$500 million of convertible trust preferred securities to investors. The junior subordinated convertible debentures and convertible trust preferred securities (together, the "2007 junior convertible trust preferred securities") have substantially the same terms.

The 2007 junior convertible trust preferred securities bear interest at 5.15% per annum, payable quarterly in cash. Each \$50 security is convertible, at any time, into 0.25 shares of our common stock, which represents a conversion price of \$200 per share (or a 53% premium to the then prevailing share price of \$130.77). Upon conversion, investors will receive cash or shares of our common stock (or a combination of cash and common stock) at our election. The 2007 junior convertible trust preferred securities may not be redeemed by us prior to October 15, 2012. On or after October 15, 2012, they may be redeemed if the closing price of our common stock exceeds \$260 per share for a specified period of time. The trust's only assets are the 2007 junior convertible subordinated debentures. To the extent that the trust has available funds, we are obligated to ensure that holders of the 2007 junior convertible trust preferred securities receive all payments due from the trust.

The 2006 and 2007 junior convertible trust preferred securities are considered contingent payment debt instruments under the federal income tax regulations. We are required to deduct interest in an amount greater than our reported interest expense. In 2008, these deductions will generate deferred taxes of approximately \$8.5 million.

### *Call Spread Option Agreements*

In 2006, we entered into a series of contracts that provided the option, but not the obligation, to repurchase up to 917,000 shares of our common stock at a weighted average price of \$99.59 per share at specified times. Upon exercise, we could elect to receive the intrinsic value of a contract in cash or common stock. During 2007, we exercised 917,000 options with a total intrinsic value of \$21.1 million. We elected to receive approximately 116,000 shares of common stock and used the remaining proceeds

(\$6.8 million) to enter into another series of contracts that provide the option, but not the obligation, to repurchase up to 800,000 shares of its common stock at a weighted average price of \$120.89 per share. These options may be exercised or will expire during the first quarter of 2008.

***Forward Purchase Contract***

In October 2007, we entered into a prepaid forward purchase contract, pursuant to which we purchased 1,578,300 shares of common stock for approximately \$206 million. We have the option to settle the forward purchase contract on or before October 15, 2012.

***Purchases of Affiliate Equity***

Many of our Affiliate operating agreements provide our Affiliate managers the conditional right to require us to purchase their retained equity interests at certain intervals. These 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 at the time the right is exercised, 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, 2007, the aggregate amount of these payments would have totaled approximately \$1,470.1 million. In the event that all such transactions were consummated, we would own the cash flow distributions attributable to the additional equity interests purchased from our Affiliate managers. As of December 31, 2007, this amount would represent approximately \$204.4 million on an annualized basis. We may pay for these purchases in cash, shares of our common stock or other forms of consideration. Affiliate management partners are also permitted to sell their equity interests to other individuals or entities in certain cases, subject to our approval or other 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, equity-based compensation and depreciation, as well as increases and decreases in our consolidated working capital.

The increase in cash flow from operations in 2007 as compared to 2006 resulted principally from increased Net Income of \$30.7 million and increased minority interest of \$29.1 million, partially offset by a \$44.8 million increase in payments of liabilities. The increase in cash flow from operations for the year ended 2006 as compared to 2005 resulted principally from increased Net Income of \$32.2 million and increased net distributions from our equity method investments of \$18.1 million, partially offset by a decrease in minority interest of \$16.1 million.

In accordance with EITF 04-05, we consolidated \$134.7 and \$108.4 million of client assets held in partnerships controlled by our Affiliates as of December 31, 2007 and 2006, respectively. Sales of client assets generated \$12.8 and \$7.7 million of operating cash flow in 2007 and 2006, respectively.



**Investing Cash Flow**

Changes in net cash flow used in investing activities result primarily from our investments in new and existing Affiliates. Net cash flow used to make investments was \$556.7 million, \$123.3 million and \$85.2 million for the years ended December 31, 2007, 2006 and 2005, respectively. These investments were funded with borrowings under our senior credit facility and existing cash. The increase in net cash flows used in investing activities in 2007 was partially offset by decreased purchases by our Affiliates in investment securities.

We may make payments in connection with our future investments. We are also contingently liable, upon achievement of specified financial targets, to make additional purchase payments of up to \$232 million through 2011. The specified financial targets for certain agreements are measured beginning December 31, 2007, and we expect we will make payments of up to \$70 million in 2008.

**Financing Cash Flow**

Net cash flows from financing activities increased \$347.6 million in 2007 as compared to 2006, primarily as a result of our \$500 million issuance of junior convertible trust preferred securities and a net increase in borrowings under our revolver of \$154.0 million, partially offset by \$436.0 million of repurchases of our common stock. The decrease in cash flows used in financing activities in 2006 from 2005 was primarily as a result of \$536.5 million of repurchases of our common stock, a use of cash that was financed by our \$300 million issuance of junior convertible trust preferred securities and a net increase of borrowings under our facility of \$190.0 million.

In accordance with Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("FAS 123R"), beginning in 2006, certain tax benefits associated with stock options have been reported as financing cash flows in the amount of \$36.5 million and \$23.0 million as of December 31, 2007 and 2006, respectively.

As more fully discussed in Liquidity and Capital Resources, in the first quarter of 2008 we retired \$300 million of our 2004 PRIDES and will retire \$300 million of floating rate convertible securities principally through the issuance of approximately 11.0 million shares of common stock.

**Contractual Obligations**

The following table summarizes our contractual obligations as of December 31, 2007:

Contractual Obligations	Payments Due				
	Total	2008	2009-2010	2011-2012	Thereafter
<i>(in millions)</i>					
Senior debt <sup>(1)</sup>	\$ 519.5	\$ 20.0	\$ 60.0	\$ 439.5	\$
Senior convertible securities <sup>(1)(2)</sup>	384.4	0.9			383.5
Mandatory convertible securities <sup>(1)(3)(4)</sup>	327.4	13.4	314.0		
Junior convertible trust preferred securities <sup>(1)(3)</sup>	2,000.2	41.1	82.1	82.1	1,794.9
Purchases of Affiliate equity <sup>(5)</sup>	1,470.1	120.3	688.0	230.3	431.5
Leases	110.5	20.2	37.1	25.7	27.5
Other liabilities <sup>(6)</sup>	71.1	70.0	1.1		
<b>Total</b>	<b>\$ 4,883.2</b>	<b>\$ 285.9</b>	<b>\$ 1,182.3</b>	<b>\$ 777.6</b>	<b>\$ 2,637.4</b>

(1) The timing of debt payments assumes that outstanding debt is settled for cash or common stock at the applicable maturity dates. The amounts include the cash payment of fixed interest.

(2) In the first quarter of 2008, we will issue approximately 7.0 million shares of our common stock in connection with conversions and privately negotiated exchanges of our floating rate convertible



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securities. Following consummation of these transactions, all of our floating rate convertible securities will be cancelled and retired and no further obligations will remain with respect thereto.

- (3) As more fully discussed on page 29, consistent with industry practice, we do not consider our mandatory convertible securities or our junior convertible trust preferred securities as debt for the purpose of determining our leverage ratio.
- (4) In the first quarter of 2008, we issued approximately 4.0 million shares of common stock in connection with privately negotiated exchanges of our mandatory convertible securities and the settlement of the forward equity purchase contracts by holders of these securities. All of our mandatory convertible securities have been cancelled and retired and no further obligations remain with respect thereto.
- (5) Purchases of Affiliate equity reflect our estimates of 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 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, 2007, the aggregate purchase amount would have totaled approximately \$1,470.1 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 \$204.4 million on an annualized basis as of December 31, 2007.
- (6) Other liabilities reflect amounts payable to Affiliate managers related to our purchase of additional Affiliate equity interests. This table does not include liabilities for uncertain tax positions (\$22.5 million as of December 31, 2007) as we cannot predict when such liabilities will be paid.

### **Market Risk**

Our revenue is derived primarily from fees which are based on the market values of assets under management. Such values are affected by changes in financial markets, and accordingly declines in the financial markets will negatively impact our revenue and Net Income. The broader financial markets are affected, in part, 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 a variable rate of interest on our senior credit facility (\$519.5 million outstanding as of December 31, 2007) and, until February 2008, have paid a variable rate of interest on our floating rate senior convertible securities. We have fixed rates of interest on our zero coupon senior convertible notes and on both of our junior convertible trust preferred securities. We have also paid fixed rates of interest on the senior notes component of our 2004 PRIDES.

From time to time, we seek to manage our exposure to changing interest rates by entering into interest rate hedging contracts. For example, through February 2008, we were a party to interest rate hedging contracts with a \$150 million notional amount, which fixed the interest rate on a portion of our floating rate senior convertible securities to a weighted average interest rate of approximately 3.28% for the period from February 2005 to February 2008. As of December 31, 2007, the unrealized gain on these contracts as of December 31, 2007 was \$0.3 million.

We estimate that a 100 basis point (1%) change in interest rates would result in a net annual change to interest expense related to our variable rate borrowings of approximately \$6.7 million. While

a change in market interest rates would not affect the interest expense incurred on our fixed rate securities, such a change may affect the fair value of these securities. We estimate that a 100 basis point (1%) change in interest rates would result in a net change in the value of our fixed rate securities of approximately \$20.5 million. We estimate that a 100 basis point (1%) change in interest rates would result in a net change in the unrealized value of our current hedging contracts of approximately \$8.0 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.

We operate primarily in the United States, and accordingly most of our consolidated revenue and associated expenses are denominated in U.S. dollars. We also provide services and earn revenue outside of the United States; therefore, the portion of our revenue and expenses denominated in foreign currencies may be impacted by movements in currency exchange rates. The valuations of our foreign Affiliates are impacted by fluctuations in foreign exchange rates, which could be recorded as a component of stockholders' equity. To illustrate the effect of possible changes in currency exchange rates, as of December 31, 2007, we estimate that a 1% change in the Canadian dollar to U.S. dollar exchange rate would result in approximately a \$3.4 million change to stockholders' equity and a \$0.5 million change to income before income taxes. During 2007, changes in currency exchange rates increased stockholders' equity by \$51.5 million.

### **Recent Accounting Developments**

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("FAS 157"). FAS 157 establishes a framework for measuring fair value applicable to other accounting standards that use fair value measurements. In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, "Effective Date of FASB Statement No. 157", which deferred the effective date of FAS 157 for one year for nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. We will be subject to certain of the provisions of FAS 157 in the first quarter of 2008. This standard is not expected to have a material impact on our consolidated financial statements, but will require certain additional disclosures.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115" ("FAS 159"). FAS 159 permits companies to measure many financial instruments and certain other items at fair value. We will adopt FAS 159 in the first quarter of 2008. This standard is not expected to have a material impact on our consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), "Business Combinations" ("FAS 141R"). FAS 141R will change the accounting for business combinations in a number of respects, including the way entities account for business combinations achieved in stages by requiring the identifiable assets and liabilities to be measured at their full fair values on the acquisition date. In addition, FAS 141R will change the treatment of contingent consideration, contingencies, acquisition costs, and restructuring costs. FAS 141R will be applied prospectively to any business combination completed after December 31, 2008. The impact of this standard will depend upon the nature, terms and size of business combinations completed after the effective date.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51" ("FAS 160"). FAS 160 will change the accounting and reporting for minority or noncontrolling interests. Upon adoption, these interests will be classified as a separate component within stockholders' equity and transactions between controlling interest and minority interest holders will be accounted for within stockholders' equity. We will adopt FAS 160 in the first quarter of 2009 and are currently evaluating the impact that this standard will have on our consolidated financial statements.

## 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 assets for impairment, we make estimates and assumptions to determine the value of our acquired client relationships, operating segments, and equity method investments. 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, projected future earnings and cash flow, 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 is material to our financial condition and operating performance and, at times, is subjective. If we used different assumptions, the carrying value of our equity method investments, our intangible assets and the 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, 2007, the carrying amounts of our intangible asset balances are as follows:

<i>(in millions)</i>	
Definite-lived acquired client relationships	\$ 233.2
Indefinite-lived acquired client relationships	263.4
Goodwill	1,230.4

These amounts exclude \$234.7 million of definite-lived acquired client relationships, and \$572.3 million of goodwill that are reported within Equity investments in Affiliates.

We amortize our definite-lived acquired client relationships over their expected useful lives. We reassess these lives each quarter based on historical and projected attrition rates and other events and circumstances that may influence the expected future economic benefit we will derive from the relationships. 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 \$4.8 million per year. We assess each of our definite-lived acquired client relationship for impairment at least annually by comparing their carrying value to their projected undiscounted cash flows. In the fourth quarter of 2007, we performed our most recent annual impairment test, and no impairments were 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 2007, we performed our most recent annual impairment test and no impairments were 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 2007, we performed our most recent annual impairment test and no impairments were identified.

#### ***Equity Method Investments***

For certain of our Affiliates, where we own a minority interest and have the ability to participate in decision making, we apply the equity method of accounting. Accordingly, we evaluate these investments for impairment by assessing whether the fair value of the investment has declined below its carrying value for a period considered to be other than temporary. Additionally, we would consider the magnitude of any decline in market value and the expected holding period of the investment.

If we determine that a decline in market value below our carrying value is other than temporary, an impairment charge would be recognized in the Consolidated Statements of Income to write down the carrying value of the investment to its fair value. In the fourth quarter of 2007, we completed our evaluation of investments accounted for under the equity method and no impairments were identified.

#### ***Income Taxes***

Our overall tax position requires analysis by management to estimate the expected realization of income tax assets and liabilities. Tax regulations often require items of income and expense to be included in our tax returns in different amounts and in different periods than are reflected in the financial statements. Additionally, we must assess whether to recognize the benefit of an uncertain tax position, and, if so, the appropriate amount of the benefit.

In our assessment of whether to recognize the benefit of an uncertain tax position, we consider the probability that a tax authority would sustain the tax position in an examination. For tax positions meeting a "more-likely-than-not" threshold, the amount recognized in the financial statements is the benefit expected to be realized upon ultimate settlement with the tax authority. For tax positions not meeting this threshold, no benefit is recognized.

Deferred taxes are established to reflect the differences in timing between the inclusion of items of income and expense in the financial statements and their reporting on our tax returns. Our deferred tax liabilities are generated primarily from tax-deductible intangible assets and from our convertible securities. As more fully described below, we generally believe that our intangible-related deferred taxes are unlikely to reverse, and that our deferred tax liabilities for convertible securities may not reverse. As such, we currently believe the economic benefit we realize from these sources will be permanent.

Most of 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, 2007, our estimate of the tax liability associated with such a sale or impairment charge was approximately \$193.3 million.

During 2008, our convertible securities will generate deferred taxes of approximately \$8.5 million because our interest deductions for tax purposes are greater than our reported interest expense. We believe that some or all of these deferred tax liabilities will be reclassified to equity as the securities are likely to convert to common stock when our stock price exceeds specified levels.

In addition, we also regularly assess our deferred tax assets, which consist primarily of state tax 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, 2007, we had a valuation allowance for all state tax loss carryforwards.

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 \$6.9 million in our tax expense in the period of such determination.

### ***Share-Based Compensation***

We have share-based compensation plans covering senior management, employees and directors. Prior to 2006, we accounted for share-based compensation using the intrinsic value method described in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related Interpretations. Accordingly, prior to 2006, no compensation expense was recognized from share-based compensation plans as the exercise price of all stock options granted equaled the market price of the underlying stock on the grant date of the award.

In 2006, we adopted the fair value recognition provisions of FAS 123R which requires a company to recognize share-based compensation, based on the fair value of the awards on the grant date. As a result, compensation is recognized in the financial statements for all share-based payments granted after the date of adoption, and for all awards that are unvested after that date.

Under FAS 123R, we estimate the fair value of stock option awards using the Black-Scholes option pricing model. The Black-Scholes model requires us to make assumptions about the volatility of our common stock and the expected life of our stock options based on past experience and anticipated future exercise behavior. As an example, we considered both the historical volatility of our common stock and the implied volatility from traded options in determining expected volatility.

Our options typically vest and become fully exercisable over three to five years of continued employment and do not include performance-based or market-based vesting conditions. For grants that are subject to graded vesting over a service period, we recognize expense net of expected forfeitures on a straight-line basis over the requisite service period for the entire award.

As of December 31, 2007, we had \$55.3 million in remaining unrecognized compensation cost related to stock option grants, which will be recognized over a weighted-average period of approximately four years (assuming no forfeitures).

### ***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. In addition to generating asset-based fees, over 50 Affiliate products, representing approximately \$45 billion of assets under management, also bill on the basis of absolute investment performance ("performance fees"). These products, which are primarily in the Institutional distribution channel, are generally structured to have returns that are not directly correlated to changes in broader equity indices and, if earned, the performance fee component is typically billed less frequently than the asset-based fee. Our Affiliates recognize performance fees when they are earned (i.e., when they become billable to customers) based on the contractual terms of agreements and when collection is reasonably assured. Although performance fees inherently depend on investment results and will vary from period to period, we anticipate performance fees to be a recurring component of our revenue.

### **Economic and Market Conditions**

#### ***Global Asset Management Industry***

The asset management industry has been a key driver of growth in financial services over the last decade. According to the most recent available data, assets under management across all distribution channels total approximately \$53.4 trillion globally, of which \$25.7 trillion is managed in the United States. We believe long-term prospects for overall industry growth (which have compounded at an annual rate of 16% globally over the past four 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 each of the principal distribution channels for our Affiliates' products.

#### ***U.S. Asset Management Industry***

In the Mutual Fund distribution channel, according to a 2007 industry report, more than 88 million individuals in almost 51 million households in the United States are invested in mutual funds. In 2007, net cash flows to equity mutual funds totaled over \$233 billion, and aggregate mutual fund assets totaled \$11.6 trillion at the end of 2007. 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 in the United States are primarily in retirement plans, including both defined benefit and defined contribution plans, endowments and foundations, and totaled approximately \$14.4 trillion as of December 31, 2006. Although the majority of Institutional assets are in equities (estimated to be 60% in 2006), allocations to alternative investments have continued to increase. According to a recent study of institutional investors, allocations of institutional assets to hedge funds (a core component of alternative investments) have grown from 2.5% of assets in 2001 to 7.5% in 2007, and are expected to increase to 8.9% by 2009. 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, high net worth families and individuals (those having at least \$1 million in investable assets) in the United States had aggregate assets of \$11.3 trillion at the end of 2006; industry experts expect assets in this segment of the channel to grow to \$15.8 trillion by the end of 2011. 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 \$1.1 trillion at the end of 2007 (a nearly 20% increase over year end 2006).

### **International Operations**

In connection with our international initiatives, we have offices in Sydney, Australia; London, England; and Toronto, Canada. In addition, we have international operations through Affiliates who provide some or a significant part of their investment management services to non-US clients. In the future, we may open additional offices, or invest in other investment management firms which 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, different and in some cases, less stringent, 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 "Management's Discussion and Analysis of Financial Condition and Results of Operations Market Risk" in Item 7.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

For quantitative and qualitative disclosures about how we are affected by market risk, see "Management's Discussion and Analysis of Financial Condition and Results of Operations Market Risk" in Item 7.

**Item 8. Financial Statements and Supplementary Data**

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

Management of Affiliated Managers Group, Inc. (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.

The Company's 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, 2007, 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, 2007 was effective.

The Company's internal control over financial reporting as of December 31, 2007 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report appearing on page 43, which expresses an unqualified opinion on the effectiveness of the firm's internal control over financial reporting as of December 31, 2007.

**Report of Independent Registered Public Accounting Firm**

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, changes in stockholders' equity and cash flows present fairly, in all material respects, the financial position of Affiliated Managers Group, Inc. (the "Company") at December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, 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 these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control Over Financial Reporting appearing under Item 8. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide 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.

/s/ PricewaterhouseCoopers LLP

Boston, Massachusetts  
February 29, 2008

## AFFILIATED MANAGERS GROUP, INC.

## CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share data)

	For the Years Ended December 31,		
	2005	2006	2007
Revenue	\$ 916,492	\$ 1,170,353	\$ 1,369,866
Operating expenses:			
Compensation and related expenses	365,960	472,400	579,365
Selling, general and administrative	162,078	184,019	197,967
Amortization of intangible assets	24,873	27,378	31,653
Depreciation and other amortization	7,029	8,763	10,444
Other operating expenses	21,497	23,880	18,822
	581,437	716,440	838,251
Operating income	335,055	453,913	531,615
Non-operating (income) and expenses:			
Investment and other income	(8,871)	(16,943)	(17,133)
Income from equity method investments	(26,970)	(38,318)	(58,197)
Investment income from Affiliate investments in partnerships	(445)	(3,400)	(38,877)
Interest expense	37,426	58,800	76,919
	1,140	139	(37,288)
Income before minority interest and income taxes	333,915	453,774	568,903
Minority interest	(144,263)	(212,523)	(241,987)
Minority interest in Affiliate investments in partnerships		(3,364)	(38,089)
Income before income taxes	189,652	237,887	288,827
Income taxes current	38,895	55,267	74,634
Income taxes intangible-related deferred	28,791	28,779	28,576
Income taxes other deferred	2,897	2,564	3,656
Net Income	\$ 119,069	\$ 151,277	\$ 181,961
Earnings per share basic	\$ 3.54	\$ 4.83	\$ 6.18
Earnings per share diluted	\$ 2.81	\$ 3.74	\$ 4.58
Average shares outstanding basic	33,667,542	31,289,005	29,464,764
Average shares outstanding diluted	44,689,655	45,159,002	44,921,784
Supplemental disclosure of total comprehensive income:			
Net Income	\$ 119,069	\$ 151,277	\$ 181,961
Other comprehensive income (loss)	15,219	(2,090)	50,071
Total comprehensive income	\$ 134,288	\$ 149,187	\$ 232,032

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

## AFFILIATED MANAGERS GROUP, INC.

## CONSOLIDATED BALANCE SHEETS

(in thousands)

	December 31,	
	2006	2007
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 201,729	\$ 222,954
Investment advisory fees receivable	201,385	237,636
Affiliate investments in partnerships	108,350	134,657
Affiliate investments in marketable securities	15,516	21,237
Prepaid expenses and other current assets	27,299	33,273
	<u>554,279</u>	<u>649,757</u>
Total current assets	554,279	649,757
Fixed assets, net	63,984	69,879
Equity investments in Affiliates	293,440	842,490
Acquired client relationships, net	502,066	496,602
Goodwill	1,177,227	1,230,387
Other assets	74,924	106,590
	<u>2,665,920</u>	<u>3,395,705</u>
Total assets	\$ 2,665,920	\$ 3,395,705
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 246,727	\$ 246,400
Payables to related party	41,086	69,952
	<u>287,813</u>	<u>316,352</u>
Total current liabilities	287,813	316,352
Senior debt	365,500	519,500
Senior convertible securities	413,358	378,083
Mandatory convertible securities	300,000	300,000
Junior convertible trust preferred securities	300,000	800,000
Deferred income taxes	218,584	257,022
Other long-term liabilities	11,209	33,516
	<u>1,896,464</u>	<u>2,604,473</u>
Total liabilities	\$ 1,896,464	\$ 2,604,473
Commitments and contingencies (Note 15)		
Minority interest	166,138	194,633
Minority interest in Affiliate investments in partnerships	104,096	127,397
Stockholders' equity:		
Common stock (\$.01 par value; 153,000 shares authorized; 39,024 shares outstanding in 2006 and 2007)	390	390
Additional paid-in capital	609,369	662,454
Accumulated other comprehensive income	14,666	64,737
Retained earnings	654,465	836,426
	<u>1,278,890</u>	<u>1,564,007</u>
Less: treasury stock, at cost (9,428 shares in 2006 and 10,865 shares in 2007)	(779,668)	(1,094,805)
	<u>499,222</u>	<u>469,202</u>
Total stockholders' equity	499,222	469,202

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December 31,

Total liabilities and stockholders' equity

\$	2,665,920	\$	3,395,705
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The accompanying notes are an integral part of the Consolidated Financial Statements.

## AFFILIATED MANAGERS GROUP, INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(dollars in thousands)

	Common Shares	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Shares	Treasury Shares at Cost
<b>December 31, 2004</b>	38,680,454	\$ 387	\$ 566,776	\$ 1,537	\$ 384,119	(5,394,730)	\$ (245,127)
Stock issued for option exercises			(34)			1,152,947	39,269
Tax benefit of option exercises			13,942				
Issuance of Affiliate equity interests			2,231				
Settlement of forward equity sale agreement			(14,378)				
Conversion of zero coupon convertible notes						6,533	347
Stock issued in connection with Affiliate investment	343,204	3	24,553				
Repurchase of stock						(1,189,700)	(90,532)
Net Income					119,069		
Other comprehensive income				15,219			
<b>December 31, 2005</b>	39,023,658	\$ 390	\$ 593,090	\$ 16,756	\$ 503,188	(5,424,950)	\$ (296,043)
Stock issued under option and other incentive plans			(991)			1,263,873	42,694
Tax benefit of option exercises			28,529				
Issuance of Affiliate equity interests			2,031				
Cost of call spread option agreements			(13,290)				
Conversions of zero coupon convertible notes						215,350	11,458
Repurchase of stock						(5,482,047)	(537,777)
Net Income					151,277		
Other comprehensive loss				(2,090)			
<b>December 31, 2006</b>	39,023,658	\$ 390	\$ 609,369	\$ 14,666	\$ 654,465	(9,427,774)	\$ (779,668)
Stock issued under option and other incentive plans			(23,443)			1,504,143	84,333
Tax benefit of option exercises			42,308				
Issuance of Affiliate equity interests			27,508				
Settlement of call spread option agreements			15,564			(115,789)	(8,764)
Cost of call spread option agreements			(6,800)				
Conversions of zero coupon convertible notes						667,826	35,773
Repurchase of stock, including prepaid forward purchase contract			(2,052)			(3,493,605)	(426,479)
Net Income					181,961		
Other comprehensive income				50,071			
<b>December 31, 2007</b>	39,023,658	\$ 390	\$ 662,454	\$ 64,737	\$ 836,426	(10,865,199)	\$ (1,094,805)

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



## AFFILIATED MANAGERS GROUP, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	For the Years Ended December 31,		
	2005	2006	2007
<b>Cash flow from operating activities:</b>			
Net Income	\$ 119,069	\$ 151,277	\$ 181,961
Adjustments to reconcile Net Income to net cash flow from operating activities:			
Amortization of intangible assets	24,873	27,378	31,653
Amortization of issuance costs	3,018	2,862	3,250
Depreciation and other amortization	7,029	8,763	10,444
Deferred income tax provision	31,688	31,343	32,232
Accretion of interest	1,896	2,360	2,772
Income from equity method investments, net of amortization	(26,971)	(38,318)	(58,197)
Distributions received from equity method investments	16,565	46,033	53,612
Tax benefit from exercise of stock options	13,942	5,482	5,780
Stock option expense		1,654	9,039
Other adjustments	(2,231)	8,528	5,979
Changes in assets and liabilities:			
Increase in investment advisory fees receivable	(53,846)	(52,281)	(35,963)
Decrease in Affiliate investments in partnerships		7,707	12,766
(Increase) decrease in prepaids and other current assets	(8,258)	150	(4,722)
(Increase) decrease in other assets	(126)	3,159	(3,178)
Increase in accounts payable, accrued liabilities and other long-term liabilities	32,217	65,814	21,035
Increase in minority interest	45,213	29,092	58,191
Cash flow from operating activities	204,078	301,003	326,654
<b>Cash flow used in investing activities:</b>			
Costs of investments in Affiliates, net of cash acquired	(85,175)	(123,262)	(556,683)
Purchase of fixed assets	(14,523)	(21,510)	(16,821)
Purchase of investment securities	(6,393)	(29,522)	(13,648)
Sale of investment securities	24,062	9,215	6,397
Cash flow used in investing activities	(82,029)	(165,079)	(580,755)
<b>Cash flow from (used in) financing activities:</b>			
Borrowings of senior bank debt	224,500	602,000	727,000
Repayments of senior bank debt	(100,000)	(412,000)	(573,000)
Issuance of junior convertible trust preferred securities		300,000	500,000
Repayment of debt assumed in new investment	(150,811)		
Repayment of senior debt		(65,750)	
Repurchase of senior debt	(10,000)		
Issuance of common stock	28,892	52,765	53,324
Repurchase of common stock, including prepaid forward purchase contract.	(82,317)	(536,478)	(435,997)
Issuance costs	(2,660)	(9,982)	(19,999)
Settlement of forward equity sale agreement	(14,008)		
Excess tax benefit from exercise of stock options		23,047	36,528
Cost of call spread option agreements		(13,290)	
Repayment of notes payable and other liabilities	(15,863)	(7,687)	(2,542)
Redemptions of Minority interest Affiliate investments in partnerships		(7,707)	(12,766)
Cash flow from (used in) financing activities	(122,267)	(75,082)	272,548
Effect of foreign exchange rate changes on cash and cash equivalents	364	464	2,778
Net increase in cash and cash equivalents	146	61,306	21,225
Cash and cash equivalents at beginning of period	140,277	140,423	201,729

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For the Years Ended December 31,

<b>Cash and cash equivalents at end of period</b>	\$ 140,423	\$ 201,729	\$ 222,954
Supplemental disclosure of cash flow information:			
Interest paid	\$ 39,381	\$ 59,526	\$ 77,735
Income taxes paid	29,290	29,003	30,243
Supplemental disclosure of non-cash financing activities:			
Stock issued for zero coupon senior convertible note conversions	347	11,458	35,773
Payables recorded for Affiliate equity purchases.	4,567	36,736	18,308
Stock issued in new investment	24,556		
Debt assumed in new investment	150,811		

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

**AFFILIATED MANAGERS GROUP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Business and Summary of Significant Accounting Policies**

***(a) 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 boutique investment management firms ("Affiliates"). AMG's Affiliates currently provide investment management services globally 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.

Affiliates are either organized as limited partnerships, limited liability partnerships, limited liability companies, or corporations. AMG generally has contractual arrangements with its Affiliates whereby a percentage of revenue is customarily 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. In these cases, 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 generally allocates to AMG a percentage of the Affiliate's revenue. The remaining revenue is used to pay operating expenses and profit distributions to the other owners.

The financial statements are prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP"). 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.

***(b) Principles of Consolidation***

The Company evaluates the risk, rewards, and significant terms of each of its Affiliate and other investments to determine the appropriate method of accounting. Majority-owned or otherwise controlled investments are consolidated. In many of its Affiliate investments, 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), sole manager member (in the case of Affiliates which are limited liability companies) or principal shareholder (in the case of Affiliates which are corporations). As a result, the Company generally consolidates its Affiliate investments. Investments that are determined to be Variable Interest Entities as defined by FASB Interpretation No. 46 (revised), "Consolidation of Variable Interest Entities" ("FIN46R"), are consolidated if AMG or a consolidated Affiliate is the primary beneficiary of the investment.

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 Income. As Affiliates are generally structured as pass-through entities for tax purposes, minority interest has been presented before income taxes in the Consolidated Statements of Income. 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.

AMG applies the equity method of accounting to 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. AMG or an Affiliate

**AFFILIATED MANAGERS GROUP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

also applies the equity method when their minority shareholders or partners have certain rights to remove their ability to control the entity or rights to participate in substantive operating decisions (e.g. approval of annual operating budgets, major financings, selection of senior management, etc.). For equity method investments, AMG's or the Affiliate's portion of income before taxes is included in Income from equity method investments. Other investments in which AMG or an Affiliate own less than a 20% interest and does not exercise significant influence are accounted for under the cost method. Under the cost method, income is recognized as dividends when, and if, declared.

Effective January 1, 2006, the Company implemented Emerging Issues Task Force Issue 04-05, "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights" ("EITF 04-05"). Under EITF 04-05, the Company or an Affiliate consolidates any partnership that it controls, including those interests in the partnerships in which the Company does not have ownership rights. A general partner is presumed to control a partnership unless the limited partners have certain rights to remove the general partner or other substantive rights to participate in partnership operations. Partnerships that are not controlled by the Company or an Affiliate are accounted for using the equity method of accounting.

The effect of any changes in the Company's equity interests in its Affiliates resulting from the issuance of an Affiliate's 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.

***(c) 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.

***(d) Affiliate Investments in Partnerships***

Assets of consolidated partnerships are reported as "Affiliate investments in partnerships." A majority of these assets are held by investors that are unrelated to the Company, and reported as "Minority interest in Affiliate investments in partnerships." Income from these partnerships is presented as "Investment income from Affiliate investments in partnerships" in the consolidated statements of income. The portion of this income or loss that is attributable to investors that are unrelated to the Company is reported as a "Minority interest in Affiliate investments in partnerships."

***(e) Affiliate Investments in Marketable Securities***

Affiliate investments in marketable securities are classified as either trading or available-for-sale and carried at fair value. Unrealized holding gains or losses on investments classified as available-for-sale are reported net of deferred tax as a separate component of accumulated other comprehensive income in stockholders' equity until realized. If a decline in the 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.

***(f) 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

**AFFILIATED MANAGERS GROUP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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.

***(g) 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 ("FAS") No. 13, "Accounting for Leases." These leases are classified as either capital leases or operating leases, 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.

***(h) Equity Investments in Affiliates***

For equity method investments, the Company's portion of income before taxes is included in Income from equity method investments. The Company's share of income taxes incurred directly by Affiliates accounted for under the equity method are recorded within Income taxes - current in the Consolidated Statements of Income because these taxes generally represent the Company's share of the taxes incurred by the Affiliate. Deferred income taxes incurred as a direct result of the Company's investment in Affiliates accounted for under the equity method have been included in Income taxes - intangible-related deferred in the Consolidated Statements of Income. The associated deferred tax liabilities have been classified as a component of deferred income taxes in the Consolidated Balance Sheet.

As is consistent with the equity method of accounting, for one of its equity method Affiliates based outside the United States, the Company has elected to record financial results one quarter in arrears to allow for the receipt of financial information. The Company converts the financial information of foreign investments to U.S. GAAP.

The Company periodically evaluates its equity 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 would be recognized in the Consolidated Statements of Income.

***(i) 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

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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 FAS 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 would be recorded in an amount equal to any such excess.

As of December 31, 2007, the cost assigned to all other acquired client relationships was being amortized over a weighted average life of approximately 12 years. The expected useful lives of acquired client relationships are analyzed each period and determined based on an analysis of the historical and projected attrition rates of each Affiliate's existing clients, and other factors that may influence the expected future economic benefit the Company will derive from the relationships. 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 Consolidated Statements of Income 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 segments in which the Affiliate operates. Goodwill is not amortized, but is instead reviewed 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 would be recorded in an amount equal to that excess.

As further described in Note 16, 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.

***(j) Revenue Recognition***

The Company's consolidated revenue primarily 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 generally assessed as a percentage of the investment performance realized on a client's account, generally over an annual period. Performance-based advisory fees are recognized when they are earned (i.e. when they become billable to customers) based on the contractual terms of agreements and when collection is reasonably assured. Also included in revenue are commissions earned by broker dealers, recorded on a trade date basis, and other service fees recorded as earned.

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***(k) Issuance Costs***

Issuance costs incurred in securing credit facility financing are amortized over the remaining term of the credit facility. Costs incurred to issue the zero coupon senior convertible securities, the floating rate senior convertible securities and junior convertible trust preferred securities are amortized over the earlier of the period to the first investor put date or the stated term of the security. 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 equity purchase contract component of such securities. Costs allocated to the prepaid forward purchase contract and call spread option agreements are charged directly to stockholders' equity and not amortized.

***(l) Derivative Financial Instruments***

The Company is exposed to interest rate risk inherent in its variable rate debt obligations. The Company's risk management strategy may utilize financial instruments specifically interest rate swap contracts to hedge certain interest rate exposures. For example, the Company may agree with a counter party (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, the Company intends to offset cash flow gains and losses that occur on its existing debt obligations with cash flow gains and losses on the contracts hedging these obligations.

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. Hedge effectiveness is generally 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 2005, 2006 or 2007.

***(m) Income Taxes***

On January 1, 2007, the Company adopted the provisions of Financial Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 clarifies the accounting for uncertain tax positions recognized in financial statements in accordance with FASB Statement No. 109 "Accounting for Income Taxes" ("FAS 109"). FIN 48 prescribes a recognition threshold and measurement criteria for evaluating tax positions. As allowed by FIN 48, the Company recognizes interest and other charges relating to unrecognized tax benefits as additional tax expense.

As required by FIN 48, the Company recognizes the financial statement benefit of an uncertain tax position only after considering the probability that a tax authority would sustain the position in an examination. For tax positions meeting a "more-likely-than-not" threshold, the amount recognized in the financial statements is the benefit expected to be realized upon settlement with the tax authority. For tax positions not meeting the threshold, no financial statement benefit is recognized.

The Company accounts for income taxes using the liability method. Under this method, deferred taxes are recognized for 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

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have been comprised primarily of deferred tax liabilities attributable to intangible assets and convertible securities 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, state and foreign income tax rates and the apportionment of future taxable income to jurisdictions 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.

***(n) Foreign Currency Translation***

The assets and liabilities of Affiliates that are not based in the United States are translated into U.S. dollars using exchange rates in effect as of the balance sheet date. The revenue and expenses of these Affiliates are translated into U.S. dollars using average exchange rates for the relevant period. Because of the permanent nature of the Company's investments, net translation exchange gains and losses are excluded from Net Income but are recorded in other comprehensive income. Foreign currency transaction gains and losses are reflected in Investment and other income.

***(o) Share-Based Compensation Plans***

Effective January 1, 2006, the Company adopted the fair value recognition provisions of FAS No. 123 (revised 2004), "Share-Based Payment" ("FAS 123R"). FAS 123R revises SFAS No. 123, "Accounting for Stock-Based Compensation" ("FAS 123") and supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"). FAS 123R requires as an expense the cost of all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values over the requisite service period. In addition, FAS 123R requires unrecognized costs related to options vesting after the date of initial adoption to be recognized as an expense in the financial statements over the remaining requisite service period.

The Company adopted FAS 123R using the modified prospective transition method. Under this method, compensation expense includes: (i) an expense for all unvested options outstanding on January 1, 2006, and (ii) an expense for all options granted subsequent to January 1, 2006. Compensation expense recognized under FAS 123R, net of tax, was \$1,042 and \$5,694 for the years ended December 31, 2006 and 2007, respectively. This additional compensation expense decreased basic



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and diluted earnings per share by \$0.03 and \$0.02, respectively, for the year ended December 31, 2006, and \$0.19 and \$0.13, respectively, for the year ended December 31, 2007.

The following table presents Net Income and earnings per share as if the Company had applied the fair value recognition provisions of FAS 123 to stock-based employee compensation for the year ended December 31, 2005.

	<b>Year Ended December 31, 2005</b>
Net Income as reported	\$ 119,069
Add: Total stock-based employee compensation expense included in reported Net Income, net of tax	
Less: Stock-based compensation expense determined under fair value method net of tax	709
Net Income FAS 123 pro forma	\$ 118,360
Earnings per share basic as reported	\$ 3.54
Earnings per share basic FAS 123 pro forma	3.52
Earnings per share diluted as reported	2.81
Earnings per share diluted FAS 123 pro forma	2.80

FAS 123R also requires the Company to report any tax benefits realized upon the exercise of stock options that are in excess of the expense recognized for reporting purposes as a financing activity in the Company's consolidated statement of cash flows. Prior to the adoption of FAS 123R, these tax benefits were presented as operating cash flows in the consolidated statements of cash flows. If the tax benefit realized is less than the expense, the tax shortfall is recognized in stockholders' equity. To the extent the expense exceeds available windfall tax benefits, it is recognized in the Consolidated Statements of Income. Under FAS 123R, the Company was permitted to calculate its cumulative windfall tax benefits for the purposes of accounting for future tax shortfalls. The Company elected to apply the long-form method for determining the pool of windfall tax benefits.

**(p) Use of Estimates**

The preparation of financial statements in conformity with U.S. GAAP 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.

**(q) Recent Accounting Developments**

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("FAS 157"). FAS 157 establishes a framework for measuring fair value applicable to other accounting standards that use fair value measurements. In February 2008, the FASB issued FASB Staff Position No. 157-2, "Effective Date of FASB Statement No. 157", which deferred the effective date of FAS 157 for one year for nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company will be subject to certain of the provisions of FAS 157 in the first quarter of 2008. This standard is not expected to have a material impact on the Company's consolidated financial statements, but will require certain additional disclosures.

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In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115" ("FAS 159"). FAS 159 permits companies to measure many financial instruments and certain other items at fair value. The Company will adopt FAS 159 in the first quarter of 2008. This standard is not expected to have a material impact on the Company's consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), "Business Combinations" ("FAS 141R"). FAS 141R will change the accounting for business combinations in a number of respects, including the way entities account for business combinations achieved in stages by requiring the identifiable assets and liabilities to be measured at their full fair values on the acquisition date. In addition, FAS 141R will change the treatment of contingent consideration, contingencies, acquisition costs, and restructuring costs. FAS 141R will be applied prospectively to any business combination completed after December 31, 2008. The impact of this standard will depend upon the nature, terms and size of business combinations completed after the effective date.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51" ("FAS 160"). FAS 160 will change the accounting and reporting for minority or noncontrolling interests. Upon adoption, these interests will be classified as a separate component within stockholders' equity and transactions between controlling interest and minority interest holders will be accounted for within stockholders' equity. The Company will adopt FAS 160 in the first quarter of 2009 and is currently evaluating the impact that this standard will have on the consolidated financial statements.

## 2. Concentrations of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash investments. The Company maintains cash and cash equivalents, 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. Affiliate Investments in Partnerships

Purchases and sales of investments (principally equity securities) and gross client subscriptions and redemptions relating to Affiliate investments in partnerships were as follows:

	At December 31,	
	2006	2007
Purchase of investments	\$ 158,311	\$ 285,001
Sale of investments	167,246	295,799
Gross subscriptions	498	4,523
Gross redemptions	8,205	17,289

Management fees earned by the Company on partnership assets were \$1,148 and \$1,309 for the years ended December 31, 2006 and 2007, respectively.

## AFFILIATED MANAGERS GROUP, INC.

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As of December 31, 2006 and December 31, 2007, the Company's investments in partnerships that are not controlled by its Affiliates were \$21,449 and \$19,799, respectively. These assets are reported within "Other assets" in the consolidated balance sheet. The income or loss related to these investments is classified within "Investment and other income" in the consolidated statement of income.

**4. Affiliate Investments in Marketable Securities**

The cost of Affiliate investments in marketable securities, gross unrealized gains and losses were as follows:

	At December 31,	
	2006	2007
Cost of Affiliate investments in marketable securities	\$ 14,342	\$ 20,272
Gross unrealized gains	1,379	1,866
Gross unrealized losses	205	901

**5. Fixed Assets and Lease Commitments**

Fixed assets consisted of the following:

	At December 31,	
	2006	2007
Building and leasehold improvements	\$ 44,495	\$ 49,767
Office equipment	22,786	30,457
Furniture and fixtures	13,345	14,741
Land and improvements	13,403	15,203
Computer software	8,965	9,314
Fixed assets, at cost	102,994	119,482
Accumulated depreciation and amortization	(39,010)	(49,603)
Fixed assets, net	\$ 63,984	\$ 69,879

The Company and its Affiliates lease office space and computer equipment for their operations. At December 31, 2007, 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
2008	\$ 20,194
2009	19,965
2010	17,125
2011	14,265
2012	11,386
Thereafter	27,552

Consolidated rent expense for 2005, 2006 and 2007 was \$18,151, \$19,574 and \$20,283, respectively.

## AFFILIATED MANAGERS GROUP, INC.

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**6. Accounts Payable and Accrued Liabilities**

Accounts payable and accrued liabilities consisted of the following:

	At December 31,	
	2006	2007
Accrued compensation	\$ 156,674	\$ 169,382
Accrued income taxes	29,550	22,960
Accrued interest	6,402	12,542
Accrued professional services	7,287	10,978
Accrued subadvisory fees	5,218	5,541
Accounts payable	9,359	4,971
Accrued rent	2,635	3,029
Deferred revenue	953	1,487
Accrued share repurchases	9,518	
Contract adjustment payments	6,025	1,263
Other	13,106	14,247
	\$ 246,727	\$ 246,400

**7. Benefit Plans**

The Company has three defined contribution plans consisting of a qualified employee profit-sharing plan covering substantially all of its full-time employees and several of its Affiliates, and non-qualified plans for certain senior employees. AMG's other Affiliates generally 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.

The Company's non-qualified Executive Retention Plan (the "ERP") is designed to work in concert with the Company's stockholder-approved Long-Term Executive Incentive Plan, providing a trust vehicle for long-term compensation awards based upon the Company's performance and growth. The ERP permits the Compensation Committee to make awards that may be invested by the recipient in the Company's common stock, in Affiliate investment products, and in cash accounts, in each case subject to vesting and forfeiture provisions. The Company's contributions to the ERP are irrevocable. In addition, the Company has established a Deferred Compensation Plan that provides officers and directors of the Company the opportunity to voluntarily defer base salary, bonus payments and director fees, as applicable, on a pre-tax basis, and invest such deferred amounts in one or more specified measurement funds. While the Company has no obligation to do so, the Deferred Compensation Plan also provides the Company the opportunity to make discretionary contributions; in the event any such contributions are made, contributed amounts will be subject to vesting and forfeiture provisions.

Consolidated expenses related to the Company's benefit plans in 2005, 2006 and 2007 were \$20,864, \$10,336 and \$10,374, respectively.

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**8. Senior Debt**

Senior debt is comprised of:

	At December 31,	
	2006	2007
Senior credit facility	\$ 365,500	\$ 519,500

On November 27, 2007, the Company entered into an amended and restated senior credit facility (the "Facility"). The Facility allows the Company to borrow an aggregate of \$950,000. The Facility is comprised of a \$750,000 revolving credit facility (the "Revolver") and a \$200,000 term loan (the "Term Loan"). The Company pays interest on these obligations at specified rates (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 rating. The Term Loan requires principal payments to be made at specified dates until maturity. Subject to the agreement of lenders to provide additional commitments, the Company has the option to increase the Facility by up to an additional \$250,000.

The Facility will mature in February 2012, and contains financial covenants with respect to leverage and interest coverage. The Facility also contains customary affirmative and negative covenants, including limitations on indebtedness, liens, cash dividends and fundamental corporate changes. Borrowings under the Facility are collateralized by pledges of the substantial majority of 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 amounted to \$676, \$602 and \$443 in 2005, 2006 and 2007, respectively.

**9. Senior Convertible Securities**

The components of senior convertible securities are as follows:

	At December 31,	
	2006	2007
Zero coupon senior convertible notes	\$ 113,358	\$ 78,083
Floating rate senior convertible securities	300,000	300,000
	\$ 413,358	\$ 378,083

*Zero Coupon Senior Convertible Notes*

In 2001, the Company issued \$251,000 of principal amount at maturity of zero coupon senior convertible notes due 2021 ("zero coupon convertible notes"), with each note issued at 90.50% of such principal amount and accreting at a rate of 0.50% per year. As of December 31, 2007, \$83,452 principal amount at maturity remains outstanding. Each security is convertible into 17.429 shares of the Company's common stock (at a current base conversion price of \$53.68) upon the occurrence of certain events, including the following: (i) if the closing price of a share of its 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 the Company calls the securities for redemption. The holders may require the Company to repurchase the securities at their accreted value in May 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

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the securities for cash at their accreted value. Under the terms of the indenture governing the zero coupon convertible notes, a holder may convert such security into common stock by following the conversion procedures in the indenture. Subject to changes in the price of the Company's common stock, the zero coupon convertible notes may not be convertible in certain future periods.

In 2006, the Company amended the zero coupon convertible notes. Under the terms of this amendment, the Company will pay interest through May 7, 2008 at a rate of 0.375% per year on the principal amount at maturity of the notes in addition to the accrual of the original issue discount.

*Floating Rate Senior Convertible Securities (See also Note 27 Subsequent Events)*

In 2003, the Company issued \$300,000 of floating rate senior convertible securities due 2033 ("floating rate convertible securities"), bearing interest at a rate equal to 3-month LIBOR minus 0.50%, payable quarterly in cash. Each security is convertible into shares of the Company's common stock (at a base conversion price of \$54.17) 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 to the securities 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 the base conversion price 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, 2007, upon conversion, a holder of each security would receive an additional 6.062 shares. The holders of the floating rate convertible securities may require the Company to repurchase such securities in February 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 the Company's common stock or some combination thereof. The Company has rights to redeem the convertible securities for cash at any time on or after February 25, 2008, at their principal amount plus accrued and unpaid interest. Under the terms of the indenture governing the floating rate convertible securities, a holder may convert such security into common stock by following the conversion procedures in the indenture; subject to changes in the price of the Company's common stock, floating rate convertible securities may not be convertible in certain future periods.

In the first quarter of 2008, the Company called the outstanding floating rate convertible securities for redemption. In lieu of redemption, substantially all of the holders elected to convert their securities. Following the consummation of these transactions, all of the Company's floating rate convertible securities will be cancelled and retired.

The floating rate senior convertible securities are considered contingent payment debt instruments under federal income tax regulations. These regulations required the Company to deduct interest in an amount greater than its reported interest expense, and resulted in annual deferred tax liabilities of \$3,700. Because the trading price of the Company's common stock exceeded \$60.90 at the time of the conversions, \$18,292 of accumulated deferred tax liabilities attributable to these securities will be reclassified to stockholders' equity.

**10. Mandatory Convertible Securities (See also Note 27 Subsequent Events)**

In 2004, the Company issued \$300,000 of mandatory convertible securities ("2004 PRIDES"), each unit consisting of (i) a senior note due February 2010 with a principal amount of \$1,000 per note, with interest payable quarterly at the annual rate of 4.125%, and (ii) a forward equity purchase contract

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pursuant to which the holder agreed to purchase shares of the Company's common stock in February 2008. The holder's obligations under the forward equity purchase contracts were collateralized by the pledge of the senior notes to the Company. The number of shares to be issued in February 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, 2007, the purchase contracts would have a settlement rate of 13.519.

In the first quarter of 2008, the Company repurchased the outstanding senior notes component of its 2004 PRIDES. Following the consummation of these transactions, all of the 2004 PRIDES have been cancelled and retired.

**11. Junior Convertible Trust Preferred Securities**

In 2006, the Company issued \$300,000 of junior subordinated convertible debentures due 2036 to a wholly-owned trust simultaneous with the issuance, by the trust, of \$291,000 of convertible trust preferred securities to investors. The junior subordinated convertible debentures and convertible trust preferred securities (together, the "2006 junior convertible trust preferred securities") have substantially the same terms.

The 2006 junior convertible trust preferred securities bear interest at a rate of 5.1% per annum, payable quarterly in cash. Each \$50 security is convertible, at any time, into 0.333 shares of the Company's common stock, which represents a conversion price of \$150 per share (or a 48% premium to the then prevailing share price of \$101.45). Upon conversion, investors will receive cash or shares of the Company's common stock (or a combination of cash and common stock) at the election of the Company. The 2006 junior convertible trust preferred securities may not be redeemed by the Company prior to April 15, 2011. On or after April 15, 2011, they may be redeemed if the closing price of the Company's common stock exceeds \$195 per share for a specified period of time. The trust's only assets are the junior convertible subordinated debentures. To the extent that the trust has available funds, the Company is obligated to ensure that holders of the 2006 convertible trust preferred securities receive all payments due from the trust.

In October 2007, the Company issued an additional \$500,000 of junior subordinated convertible debentures which are due 2037 to a wholly-owned trust simultaneous with the issuance, by the trust, of \$500,000 of convertible trust preferred securities to investors. The junior subordinated convertible debentures and convertible trust preferred securities (together, the "2007 junior convertible trust preferred securities") have substantially the same terms as the 2006 junior subordinated convertible debentures.

The 2007 junior convertible trust preferred securities bear interest at 5.15% per annum, payable quarterly in cash. Each \$50 security is convertible, at any time, into 0.25 shares of the Company's common stock, which represents a conversion price of \$200 per share (or a 53% premium to the then prevailing share price of \$130.77). Upon conversion, investors will receive cash or shares of the Company's common stock (or a combination of cash and common stock) at the election of the Company. The 2007 junior convertible trust preferred securities may not be redeemed by the Company prior to October 15, 2012. On or after October 15, 2012, they may be redeemed if the closing price of the Company's common stock exceeds \$260 per share for a specified period of time. The trust's only assets are the 2007 junior convertible subordinated debentures. To the extent that the trust has

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available funds, the Company is obligated to ensure that holders of the convertible trust preferred securities receive all payments due from the trust.

**12. Income Taxes**

Effective January 1, 2007, the Company adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 clarifies the accounting for liabilities related to tax return positions that may be deemed to be uncertain. On January 1, 2007 the Company carried a liability for uncertain tax positions of \$21,315, including \$3,761 for interest and related charges. On December 31, 2007, this liability was \$22,506, including interest and related charges of \$3,877. The adoption of FIN 48 did not result in an adjustment to the Company's liability for uncertain tax positions or retained earnings. These liabilities at January 1, 2007 and December 31, 2007 included \$11,847 and \$12,619, respectively, for tax positions that, if recognized, would affect the Company's effective tax rate. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Balance at January 1, 2007	\$	21,315
Additions based on tax positions related to current year		4,381
Additions based on tax positions of prior years		116
Reductions for tax provisions of prior years		
Settlements		
Reductions related to lapses of statutes of limitations		(3,306)
		<u>          </u>
Balance at December 31, 2007	\$	<u>22,506</u>

The Company or its subsidiaries files income tax returns in federal, various state, and foreign jurisdictions. With few exceptions, the Company is no longer subject to income tax examinations by any tax authorities for years before 2004.

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

		Year Ended December 31,		
		2005	2006	2007
Current:	Federal	\$ 31,399	\$ 38,971	\$ 52,012
	State	2,005	6,344	8,124
	Foreign	5,491	9,952	14,498
Deferred:	Federal	30,424	33,261	33,582
	State	2,158	1,900	1,954
	Foreign	(894)	(3,818)	(3,304)
		<u>          </u>	<u>          </u>	<u>          </u>
		\$ 70,583	\$ 86,610	\$ 106,866

The components of income before income taxes consisted of the following:

		Year Ended December 31,		
		2005	2006	2007
Domestic		\$ 163,912	\$ 186,249	\$ 221,798
Foreign		25,740	51,638	67,029
		<u>          </u>	<u>          </u>	<u>          </u>
		\$ 189,652	\$ 237,887	\$ 288,827



Year Ended December 31,

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## AFFILIATED MANAGERS GROUP, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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,		
	2005	2006	2007
Tax at U.S. federal income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	1.4	2.2	1.6
Non-deductible expenses	0.2		0.2
Valuation allowance	0.6	0.8	1.3
Foreign taxes	2.9	2.6	3.9
Foreign tax credits	(2.9)	(4.2)	(5.0)
	<u>37.2%</u>	<u>36.4%</u>	<u>37.0%</u>

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

	At December 31,	
	2006	2007
Deferred assets (liabilities):		
Intangible asset amortization	\$ (170,216)	\$ (193,275)
Convertible securities interest	(19,807)	(28,215)
Non-deductible intangible amortization	(26,946)	(26,668)
State net operating loss and credit carryforwards	14,126	18,023
Deferred compensation		(8,005)
Fixed asset depreciation	(1,956)	(3,562)
Accrued expenses	739	2,196
Deferred income	(398)	507
	<u>(204,458)</u>	<u>(238,999)</u>
Valuation allowance	(14,126)	(18,023)
Net deferred income taxes	\$ (218,584)	\$ (257,022)

Deferred tax liabilities are primarily the result of tax deductions for the Company's intangible assets and convertible securities. The Company amortizes most of its intangible assets for tax purposes only, reducing its tax basis below its carrying value for financial statement purposes and generating deferred taxes each reporting period. In contrast, the intangible assets associated with the Company's recent investment in its Canadian Affiliates are not deductible for tax purposes, but certain of these assets are amortized for book purposes. As such, at the time of its investment, the Company recorded a deferred tax liability that represents the tax effect of the future book amortization of these assets. The Company's floating rate senior convertible securities, mandatory convertible securities and junior convertible trust preferred securities also currently generate tax deductions that are higher than the interest expense recorded for financial statement purposes.

At December 31, 2007, the Company had state net operating loss carryforwards that will expire over a 15-year period beginning in 2006. The valuation allowances at December 31, 2006 and 2007 are related to the uncertainty of the realization of most of these loss carryforwards, which realization depends upon the Company's generation of sufficient taxable income prior to their expiration. The

## AFFILIATED MANAGERS GROUP, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

change in the valuation allowance for the year ended December 31, 2007 is principally attributable to state net operating losses during this period and a provision for loss carryforwards that the Company does not expect to realize.

In 2006, the Company reduced its deferred tax liabilities for non-deductible intangible amortization by \$1,408 to reflect a reduction in Canadian federal income tax rates that was enacted in June 2006 and will become effective beginning in 2008. The reduction of these deferred tax liabilities was recorded as a benefit in the 2006 income tax provision.

**13. Derivative Financial Instruments**

The Company periodically uses interest rate hedging contracts to manage market exposures associated with changing interest rates. As of December 31, 2007, the Company was a party to interest rate hedging contracts with a \$150 million notional amount, which fixed the interest rate on a portion of the floating rate senior convertible securities to a weighted average interest rate of approximately 3.28% through February 2008.

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, 2006 and 2007, the unrealized gain, before taxes, on the derivative instruments was \$2,392 and \$283, respectively. The Company expects no portion of the unrealized gain to be reclassified from accumulated other comprehensive income to Net Income over the next 12 months.

**14. Comprehensive Income**

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

	For the year ended December 31,		
	2005	2006	2007
Net Income	\$ 119,069	\$ 151,277	\$ 181,961
Foreign currency translation adjustment	13,781	(1,832)	51,475
Change in net unrealized gain (loss) on derivative instruments	2,098	(358)	(1,328)
Change in unrealized gain (loss) on investment securities	(50)	100	(76)
Reclassification of unrealized gain on investment securities to realized gain	(610)		
Comprehensive income	\$ 134,288	\$ 149,187	\$ 232,032

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

	At December 31,	
	2006	2007
Foreign currency translation adjustment	\$ 13,081	\$ 64,556
Unrealized gain on derivative instruments	1,508	180
Unrealized gain (loss) on investment securities	77	1
Accumulated other comprehensive income	\$ 14,666	\$ 64,737

**AFFILIATED MANAGERS GROUP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**15. 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.

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

**16. Business Combinations**

The Company's Affiliate investments totaled \$267,169, \$144,580 and \$610,235 in the years ended December 31, 2005, 2006 and 2007 respectively. These investments were made pursuant to the Company's growth strategy designed to generate shareholder value by making investments in boutique investment management firms and other strategic transactions designed to expand the Company's participation in its three principal distribution channels.

In December 2007, the Company acquired a minority interest in BlueMountain Capital Management ("BlueMountain"), a leading global credit alternatives manager specializing in relative value strategies in the corporate loan, bond, credit and equity derivatives markets. BlueMountain has offices in New York and London, and manages assets on behalf of predominantly institutional and high net worth clients. This transaction was financed through borrowings under the Company's senior credit facility.

In November 2007, the Company acquired a minority interest in ValueAct Capital ("ValueAct"), a San Francisco-based alternative investment firm that establishes ownership interests in undervalued companies and works with each company's management and Board of Directors to implement business strategies that enhance shareholder value. ValueAct has over 250 clients, including endowments, foundations, corporations, family offices, high net worth investors and funds of funds. This transaction was financed through borrowings under the Company's senior credit facility.

In 2006, the Company expanded its product offerings in the Institutional distribution channel through the acquisition of a majority equity interest in Chicago Equity Partners, LLC ("Chicago Equity"), which manages a wide range of U.S. equity and fixed income products across multiple capitalization sectors and investment styles. The firm's client base includes over 120 institutional investors, including public funds, corporations, endowments and foundations, Taft-Hartley plan sponsors and certain mutual fund advisers. The transaction was financed through borrowings under the Company's senior credit facility.

In 2005, the Company completed the acquisition of a group of Canadian asset management firms. These firms manage approximately 100 investment products, including Canadian, U.S. and international value and growth equity products, as well as balanced, fixed income, venture capital and structured products. These firms operate in each of the Company's three distribution channels. The transaction was financed through borrowings under the Company's senior credit facility, the issuance of common stock, and available cash.

## AFFILIATED MANAGERS GROUP, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In 2005, through Managers Investment Group LLC, the Company completed the acquisition of approximately \$3.0 billion of assets under management from Fremont Investment Advisors, Inc. ("FIA"). The acquisition included the Fremont Funds, a diversified family of no load mutual funds managed by independent sub advisors and professionals at FIA, as well as FIA assets in separate accounts and 401(k) plans. The transaction was financed through available cash.

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 as of the respective acquisition dates during the years ended December 31, 2006 and 2007:

	2006 <sup>(1)</sup>	2007
Current assets, net	\$ 11,488	\$
Fixed assets	2,045	
Definite-lived acquired client relationships	43,481	19,876
Indefinite-lived acquired client relationships	2,611	4,577
Equity investments in Affiliates <sup>(2)</sup>		541,377
Goodwill	87,040	18,262
<b>Net assets acquired</b>	<b>\$ 146,665</b>	<b>\$ 584,092</b>

(1)

In 2007, the Company finalized the purchase price allocation of Chicago Equity.

(2)

The Company's 2007 investments in BlueMountain and ValueAct are accounted for under the equity method of accounting. The Company's purchase price allocations of these investments are subject to the finalization of the valuations of acquired client relationships. As a result, these preliminary amounts may be revised in future periods.

Unaudited pro forma financial results are set forth below, giving consideration to the investments and acquisitions in 2006 and 2007, as if such transactions occurred as of the beginning of 2006, assuming revenue sharing arrangements had been in effect for the entire period and after making certain other pro forma adjustments.

	Year Ended December 31,	
	2006	2007
Revenue	\$ 1,201,686	\$ 1,369,866
Net Income	167,000	172,581
Earnings per share basic	\$ 5.34	\$ 5.86
Earnings per share diluted	4.09	4.37

In connection with certain investments in Affiliates, the Company is contingently liable, upon achievement of specified financial targets, to make additional purchase payments of up to \$232,000 through 2011. The Company expects it will make payments of up to \$70,000 in 2008. If these payments occur, the Company will record incremental goodwill. As of December 31, 2007 the Company has recorded \$50,000 of these payments because certain of these targets had been achieved.

## AFFILIATED MANAGERS GROUP, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In addition to the investments described above, in the years ended December 31, 2005, 2006, and 2007, the Company completed additional investments in existing Affiliates and transferred interests in certain affiliated investment management firms. The financial effect of these transactions was not material to the Company's results.

Many of 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 the Company 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, 2007, the aggregate amount of these payments would have totaled approximately \$1,470,100. 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, 2007, this amount would represent approximately \$204,400 on an annualized basis.

**17. Goodwill and Acquired Client Relationships**

In 2006 and 2007, the Company acquired interests from and transferred interests to Affiliate management partners. Most of the goodwill acquired during the year is tax deductible.

The following table presents the change in goodwill during 2006 and 2007.

	<u>Mutual Fund</u>	<u>Institutional</u>	<u>High Net Worth</u>	<u>Total</u>
Balance, as of December 31, 2005	\$ 437,309	\$ 445,609	\$ 210,331	\$ 1,093,249
Goodwill acquired, net	17,490	58,692	8,350	84,532
Foreign currency translation	(238)	(233)	(83)	(554)
	<u>454,561</u>	<u>504,068</u>	<u>218,598</u>	<u>1,177,227</u>
Balance, as of December 31, 2006	454,561	504,068	218,598	1,177,227
Goodwill acquired, net	3,881	9,604	2,715	16,200
Foreign currency translation	15,893	15,523	5,544	36,960
	<u>474,335</u>	<u>529,195</u>	<u>226,857</u>	<u>1,230,387</u>
Balance, as of December 31, 2007	\$ 474,335	\$ 529,195	\$ 226,857	\$ 1,230,387

In connection with the Company's equity method investments, approximately \$185,300 and \$572,323 of goodwill has been classified within Equity investments in Affiliates as of December 31, 2006 and 2007, respectively.

## AFFILIATED MANAGERS GROUP, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table reflects the components of intangible assets of the Company's Affiliates that are consolidated as of December 31, 2006 and 2007:

	2006		2007	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
<b>Amortized intangible assets:</b>				
Acquired client relationships	\$ 379,703	\$ 136,486	\$ 401,303	\$ 168,139
<b>Non-amortized intangible assets:</b>				
Acquired client relationships mutual fund management contracts	258,849		263,438	
Goodwill	1,177,227		1,230,387	

For the Company's Affiliates that are consolidated, definite-lived acquired client relationships are amortized over their expected useful lives. As of December 31, 2007, these relationships were being amortized over a weighted average life of 11 years. The Company estimates that its consolidated annual amortization expense will be approximately \$31,500 for the next five years, assuming no useful life changes or additional investments in new or existing Affiliates.

The definite-lived acquired client relationships attributable to the Company's equity method investments are amortized over their expected useful lives. As of December 31, 2007, these relationships were being amortized over approximately 13 years. Amortization expense for these relationships was \$9,290 and \$10,386 for 2006 and 2007, respectively. The Company estimates that the annual amortization expense attributable to its current equity-method Affiliates will be approximately \$20,000 for the next five years assuming no useful life changes.

#### 18. Minority Interest

Minority interest in the Consolidated Statements of Income includes the income allocated to owners of consolidated Affiliates, other than AMG. For the years ended December 31, 2005, 2006 and 2007, this income was \$144,263, \$212,523 and \$241,987, respectively. Minority interest on the Consolidated Balance Sheets includes capital and undistributed profits owned by the managers of the consolidated Affiliates (including profits allocated to managers from the Owners' Allocation and Operating Allocation). For the years ended December 31, 2005, 2006 and 2007, profit distributions to management owners were \$185,732, \$287,899 and \$321,505, respectively.

#### 19. 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*

The Company's Board of Directors has authorized the issuance of up to 150,000,000 shares of Voting Common Stock and 3,000,000 shares of Class B Non-Voting Common Stock.

**AFFILIATED MANAGERS GROUP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

In recent periods, the Company's Board of Directors has authorized the following share repurchase programs:

in March 2006 in connection with the issuance of the 2006 junior convertible trust preferred securities, up to an additional 4,000,000 shares of common stock;

in July 2006, up to an additional 1,516,943 shares of common stock;

in February 2007, up to an additional 3,000,000 shares of common stock; and

in October 2007, in connection with the issuance of the 2007 junior convertible trust preferred securities up to an additional 2,500,000 shares pursuant to a prepaid forward purchase contract which the Company may elect to settle on or before October 15, 2012.

The timing and amount of purchases are determined at the discretion of AMG's management. In the year ended December 31, 2006, the Company repurchased 5,482,047 shares of common stock at an average price of \$98.10 per share. In the year ended December 31, 2007, the Company repurchased 3,609,394 shares of common stock at an average price of \$120.59 per share (including 1,578,300 shares through its prepaid forward purchase agreement and 115,789 shares of common stock upon the settlement of certain call spread option agreements). As of December 31, 2007, the Company had the ability to acquire up to 1,880,106 shares of common stock under its authorized share repurchase program.

In the first quarter of 2008, the Company will issue an aggregate of approximately 11,000,000 shares of voting common stock in connection with certain private exchanges and conversions of its floating rate convertible securities and certain private exchanges and the settlement of the forward equity purchase contracts related to its 2004 PRIDES, as more fully discussed in Note 27.

***Financial Instruments***

The Company's 2004 PRIDES contain freestanding forward equity contracts that required holders to purchase shares of the Company's common stock in February 2008. Additionally, the Company's zero coupon convertible notes, floating rate convertible securities and junior convertible trust preferred securities contain an embedded right for holders to receive shares of the Company's common stock under certain conditions. All of these arrangements, the forward equity sale agreement, the forward equity purchase contract and call spread option agreements meet the definition of equity under FASB Emerging Issues Task Force Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock" and are not required to be accounted for separately as derivative instruments.

***Stock Option and Incentive Plans***

The Company established the 1997 Stock Option and Incentive Plan (as amended and restated, the "1997 Plan"), under which it is authorized to grant options to employees and directors. 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 (as amended and restated, the "2002 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 was approved by the



## AFFILIATED MANAGERS GROUP, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Company's Board of Directors. There are 3,375,000 shares of the Company's common stock authorized for issuance under this plan.

In December 2003, the Board of Directors approved an amendment to each of the 1997 Plan and 2002 Plan to accelerate the vesting of the then-outstanding unvested options (other than options granted to directors). 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 by the Company, the transfer restrictions will remain outstanding until the later of December 2010, or seven years after the date of grant.

In May 2006, the stockholders of the Company approved the 2006 Stock Option and Incentive Plan (the "2006 Plan"), under which the Company is authorized to grant stock options and stock appreciation rights to senior management, employees and directors. There are 3,000,000 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. Under the plans, options generally vest over a period of three to five years and expire seven to ten years after the grant date. All options have been granted with exercise prices equal to the fair market value of the Company's common stock on the date of grant.

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

	Stock Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)
Unexercised options outstanding January 1, 2007	7,404,822	\$ 50.49	
Options granted	1,480,500	115.85	
Options exercised	(1,514,912)	35.40	
Options forfeited	(189,624)	71.63	
Unexercised options outstanding December 31, 2007	7,180,786	66.59	5.0
Exercisable at December 31, 2007	4,967,459	46.88	4.2
Exercisable and free from restrictions on transfer at December 31, 2007	4,424,228	45.04	3.8

The Company generally uses treasury stock to settle stock option exercises. The total intrinsic value of options exercised during the years ended December 31, 2005, 2006 and 2007 was \$41,442, \$78,371 and \$115,568, respectively. As of December 31, 2007, the intrinsic value of options that were vested and free from restrictions on transfer was \$320,403. As of that date, the total intrinsic value of all vested options (including those subject to restrictions on transfer) was \$350,603, and the intrinsic value of unvested options was \$14,683.

During the year ended December 31, 2007, the cash received and the actual tax benefit recognized for options exercised were \$52,417 and \$42,308, respectively. During the year ended December 31, 2007, the excess tax benefit classified as a financing cash flow was \$36,528. During the year ended December 31, 2006, the cash received and the actual tax benefit recognized for options exercised were \$41,886 and \$28,529, respectively. During the year ended December 31, 2006, the excess tax benefit classified as a financing cash flow was \$23,047.

## AFFILIATED MANAGERS GROUP, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company's Net Income for the year ended December 31, 2007 includes \$9,039 of compensation expense and \$3,345 of income tax benefits, related to the share-based compensation arrangements. The Company's Net Income for the year ended December 31, 2006 includes \$1,654 of compensation expense and \$612 of income tax benefits, related to the share-based compensation arrangements. As of December 31, 2007, there was \$55,315 of deferred compensation expense related to stock options which will be recognized over a weighted average period of approximately four years (assuming no forfeitures).

The fair value of options granted is estimated using the Black-Scholes option pricing model. The weighted average fair value of options granted during the years ended December 31, 2005, 2006 and 2007 was \$20.95, \$28.66 and \$26.88 per option, respectively, based on the assumptions stated below.

	Year Ended December 31,		
	2005	2006	2007
Dividend yield	0.0%	0.0%	0.0%
Expected volatility <sup>(1)</sup>	19.9%	22.6%	23.8%
Risk-free interest rate <sup>(2)</sup>	4.4%	4.9%	3.1%
Expected life of options (in years) <sup>(3)</sup>	5.0	4.4	3.8
Forfeiture rate <sup>(3)</sup>	0.0%	5.0%	5.0%

(1) Based on the historical and implied volatility of the Company's common stock.

(2) Based on the U.S. Treasury yield curve in effect at the date of grant.

(3) Based on historical data and expected exercise behavior.

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.

## 20. Call Spread Option Agreements

In 2006, the Company entered into a series of contracts that provided the option, but not the obligation, to repurchase up to 917,000 shares of its common stock at a weighted average price of \$99.59 per share at specified times. Upon exercise, the Company could elect to receive the intrinsic value of a contract in cash or common stock. During 2007, the Company exercised 917,000 options with a total intrinsic value of \$21,149. The Company elected to receive approximately 116,000 shares of common stock and used the remaining proceeds (\$6,800) to enter into another series of contracts that provide the option, but not the obligation, to repurchase up to 800,000 shares of its common stock at a weighted average price of \$120.89 per share. These options may be exercised or will expire during the first quarter of 2008.

## 21. 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

## AFFILIATED MANAGERS GROUP, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

other dollar amounts in these Notes, the amounts in the numerator reconciliation are not presented in thousands.

	Year Ended December 31,		
	2005	2006	2007
<b>Numerator:</b>			
Net Income	\$ 119,069,000	\$ 151,277,000	\$ 181,961,000
Interest expense on contingently convertible securities, net of taxes	6,693,000	17,618,000	23,787,000
Net income, as adjusted	\$ 125,762,000	\$ 168,895,000	\$ 205,748,000

	Year Ended December 31,		
	2005	2006	2007
<b>Denominator:</b>			
Average shares outstanding basic	33,667,542	31,289,005	29,464,764
Effect of dilutive instruments:			
Stock options	2,244,874	2,542,878	2,117,478
Forward equity agreement	88,654		
Senior convertible securities	8,688,585	9,238,255	9,276,218
Mandatory convertible securities		599,853	1,540,226
Junior convertible trust preferred securities		1,489,011	2,523,098
Average shares outstanding diluted	44,689,655	45,159,002	44,921,784

The calculation of diluted earnings per share for 2005, 2006 and 2007 excludes the potential exercise of options to purchase approximately 0.1, 0.9 and 2.3 million common shares, respectively, because their effect would be anti-dilutive. In addition, the calculation of diluted earnings per share excludes the effect of the outstanding call spread option agreements for all periods presented because their effect would be anti-dilutive.

As more fully discussed in Notes 9, 10, and 11, the Company had convertible securities outstanding during the years ended December 31, 2005, 2006 and 2007. The aggregate number of shares of common stock that could be issued in the future to settle these securities is deemed outstanding for the purposes of the calculation of diluted earnings per share. This approach, referred to as the if-converted method, requires that such shares be deemed outstanding regardless of whether the securities are then contractually convertible into the Company's common stock. For this if-converted calculation, the interest expense (net of tax) 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, 2005, 2006 and 2007, the Company repurchased approximately 1.2, 5.5 and 3.6 million shares of common stock, respectively, under various stock repurchase programs. The Company has repurchased an additional 100,000 shares, from January 1 through February 26, 2008.

## 22. Financial Instruments and Risk Management

The Company is exposed to market risks brought on by changes in interest and currency exchange rates. The Company has not entered into foreign currency transactions or derivative financial instruments to reduce risks associated with changes in currency exchange rates. The Company uses derivative financial instruments to reduce risks associated with changes in interest rates.



**AFFILIATED MANAGERS GROUP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

***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 counter parties that issued the financial instruments, although the Company does not expect that the counter parties 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 counter parties.

***Interest Rate Risk Management***

From time to time, the Company enters into derivative financial instruments to reduce exposure to interest rate risk. The Company does not hold or issue derivative financial instruments for trading purposes. Derivative financial instruments are intended to enable the Company to achieve a level of variable-rate or 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 credit facility with variable interest based on selected short-term rates. The fair market value of the zero coupon senior convertible securities, the floating rate senior convertible securities, the 2004 mandatory convertible debt, and the junior convertible trust preferred securities at December 31, 2007 was \$171,076, \$866,625, \$479,625 and \$746,790, respectively.

## AFFILIATED MANAGERS GROUP, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 23. 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, 2006 and 2007.

	2006			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenue	\$ 278,042	\$ 283,108	\$ 280,440	\$ 328,763
Operating income	103,706	104,474	102,059	143,674
Income before income taxes	55,937	51,632	52,613	77,705
Net Income	35,240	33,936	33,146	48,955
Earnings per share diluted	\$ 0.81	\$ 0.86	\$ 0.87	\$ 1.21

	2007			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenue	\$ 309,837	\$ 331,464	\$ 345,605	\$ 382,960
Operating income	112,302	123,944	127,620	167,749
Income before income taxes	58,130	66,487	67,596	96,614
Net Income	36,622	41,887	42,585	60,867
Earnings per share diluted	\$ 0.93	\$ 1.04	\$ 1.07	\$ 1.53

In each of the quarters in 2007, the Company experienced an increase in revenue (and consequently operating income, income before income taxes, Net Income and Earnings per share) from the same period in 2006, primarily as a result of the growth in assets under management resulting from positive investment performance and cash flows and, to a lesser extent, from the Company's investments in new Affiliates in 2006 and 2007. In addition, the Company earns the majority of its performance fees in the fourth quarter of each year, resulting in higher revenue and Net Income when compared to earlier quarters.

## 24. Related Party Transactions

The Company periodically records amounts receivable and payable to Affiliate partners in connection with the transfer of Affiliate equity interests. As of December 31, 2006 and 2007, the total receivable (reported in "Other assets") was \$18,365 and \$35,510, respectively. The total payable as of December 31, 2006 was \$42,364, of which \$41,086 is included in current liabilities. The total payable as of December 31, 2007 was \$70,915, of which \$69,952 is included in current liabilities.

In certain cases, Affiliate management owners and Company officers may serve as trustees or directors of certain mutual funds from which the Affiliate earns advisory fee revenue.

## 25. Summarized Financial Information of Equity Method Affiliates

The following table presents summarized financial information for Affiliates accounted for under the equity method.

	2005	2006	2007
Revenue <sup>(1)(2)</sup>	\$ 1,031,024	\$ 1,476,488	\$ 747,240
Net Income	276,470	485,959	214,876

## AFFILIATED MANAGERS GROUP, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	2006	2007
Current assets <sup>(2)</sup>	\$ 7,386,894	\$ 9,306,440
Noncurrent assets	159,699	147,511
Current liabilities	1,731,477	2,368,160
Noncurrent Liabilities and Minority Interest <sup>(2)</sup>	5,170,993	6,679,065

(1) Revenue includes advisory fees for asset management services, investment income and gains and losses on investments from consolidated investment partnerships.

(2) In the 2007 investments in BlueMountain and ValueAct, the Company acquired a share of revenue but no portion of the assets held by investors that are unrelated to the Company (which include consolidated investment partnerships).

The Company's share of undistributed earnings from equity method investments totaled \$32,154 as of December 31, 2007. This footnote has been amended for changes to the historical financial statements of an equity method Affiliate. Such changes had no impact on the Company's financial position or results of operations.

## 26. 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 all domestically registered investment products as well as non-institutional investment products that are registered abroad. 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.

Revenue earned from client relationships managed by Affiliates accounted for under the equity method is not consolidated with the Company's reported revenue but instead is included (net of operating expenses, including amortization) in "Income from equity method investments", and reported in the distribution channel in which the Affiliate operates. Income tax attributable to the profits of the Company's equity method Affiliates is reported within the Company's consolidated income tax provision.

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

## AFFILIATED MANAGERS GROUP, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

expense have been allocated to segments based on the proportion of cash flow distributions reported by Affiliates in each segment.

	2005			
	Mutual Fund	Institutional	High Net Worth	Total
Revenue	\$ 400,859	\$ 385,681	\$ 129,952	\$ 916,492
Operating expenses:				
Depreciation and other amortization	4,185	17,863	9,854	31,902
Other operating expenses	235,795	231,779	81,961	549,535
	<u>239,980</u>	<u>249,642</u>	<u>91,815</u>	<u>581,437</u>
Operating income	160,879	136,039	38,137	335,055
Non-operating (income) and expenses:				
Investment and other income	(4,379)	(3,797)	(695)	(8,871)
Income from equity method investments	(516)	(25,719)	(735)	(26,970)
Investment income from Affiliate investments in partnerships			(445)	(445)
Interest expense	15,657	17,264	4,505	37,426
	<u>10,762</u>	<u>(12,252)</u>	<u>2,630</u>	<u>1,140</u>
Income before minority interest and income taxes	150,117	148,291	35,507	333,915
Minority interest	(59,658)	(66,616)	(17,989)	(144,263)
	<u>90,459</u>	<u>81,675</u>	<u>17,518</u>	<u>189,652</u>
Income before income taxes	90,459	81,675	17,518	189,652
Income taxes	33,674	30,386	6,523	70,583
	<u>56,785</u>	<u>51,289</u>	<u>10,995</u>	<u>119,069</u>
Net Income	\$ 56,785	\$ 51,289	\$ 10,995	\$ 119,069
Total assets	\$ 873,386	\$ 1,106,187	\$ 342,063	\$ 2,321,636
Goodwill	\$ 437,309	\$ 445,609	\$ 210,331	\$ 1,093,249



## AFFILIATED MANAGERS GROUP, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	2006			
	Mutual Fund	Institutional	High Net Worth	Total
Revenue	\$ 501,739	\$ 514,761	\$ 153,853	\$ 1,170,353
Operating expenses:				
Depreciation and amortization	6,734	22,511	6,896	36,141
Other operating expenses	291,571	295,733	92,995	680,299
	<u>298,305</u>	<u>318,244</u>	<u>99,891</u>	<u>716,440</u>
Operating income	203,434	196,517	53,962	453,913
Non-operating (income) and expenses:				
Investment and other income	(7,088)	(6,584)	(3,271)	(16,943)
Income from equity method investments	(1,087)	(34,503)	(2,728)	(38,318)
Investment income from Affiliate investments in partnerships			(3,400)	(3,400)
Interest expense	24,360	27,606	6,834	58,800
	<u>16,185</u>	<u>(13,481)</u>	<u>(2,565)</u>	<u>139</u>
Income before minority interest and income taxes	187,249	209,998	56,527	453,774
Minority interest	(80,333)	(106,536)	(25,654)	(212,523)
Minority interest in Affiliate investments in partnerships			(3,364)	(3,364)
	<u>106,916</u>	<u>103,462</u>	<u>27,509</u>	<u>237,887</u>
Income before income taxes	106,916	103,462	27,509	237,887
Income taxes	38,869	37,715	10,026	86,610
	<u>68,047</u>	<u>65,747</u>	<u>17,483</u>	<u>151,277</u>
Net Income	\$ 68,047	\$ 65,747	\$ 17,483	\$ 151,277
	<u>898,150</u>	<u>1,279,981</u>	<u>487,789</u>	<u>2,665,920</u>
Total assets	\$ 898,150	\$ 1,279,981	\$ 487,789	\$ 2,665,920
	<u>454,561</u>	<u>504,068</u>	<u>218,598</u>	<u>1,177,227</u>
Goodwill	\$ 454,561	\$ 504,068	\$ 218,598	\$ 1,177,227

## AFFILIATED MANAGERS GROUP, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	2007			
	Mutual Fund	Institutional	High Net Worth	Total
Revenue	\$ 558,257	\$ 645,613	\$ 165,996	\$ 1,369,866
Operating expenses:				
Depreciation and amortization	10,356	23,543	8,198	42,097
Other operating expenses	317,582	381,165	97,407	796,154
	<u>327,938</u>	<u>404,708</u>	<u>105,605</u>	<u>838,251</u>
Operating income	230,319	240,905	60,391	531,615
Non-operating (income) and expenses:				
Investment and other income	(7,121)	(6,587)	(3,425)	(17,133)
Income from equity method investments	(1,651)	(51,214)	(5,332)	(58,197)
Investment income from Affiliate investments in partnerships		(10)	(38,867)	(38,877)
Interest expense	28,317	38,772	9,830	76,919
	<u>19,545</u>	<u>(19,039)</u>	<u>(37,794)</u>	<u>(37,288)</u>
Income before minority interest and income taxes	210,774	259,944	98,185	568,903
Minority interest	(95,720)	(120,506)	(25,761)	(241,987)
Minority interest in Affiliate investments in partnerships		(10)	(38,079)	(38,089)
	<u>115,054</u>	<u>139,428</u>	<u>34,345</u>	<u>288,827</u>
Income before income taxes	115,054	139,428	34,345	288,827
Income taxes	42,570	51,589	12,707	106,866
	<u>72,484</u>	<u>87,839</u>	<u>21,638</u>	<u>181,961</u>
Net Income	\$ 72,484	\$ 87,839	\$ 21,638	\$ 181,961
	<u>986,308</u>	<u>1,832,951</u>	<u>576,446</u>	<u>3,395,705</u>
Total assets	\$ 986,308	\$ 1,832,951	\$ 576,446	\$ 3,395,705
	<u>474,335</u>	<u>529,195</u>	<u>226,857</u>	<u>1,230,387</u>
Goodwill	\$ 474,335	\$ 529,195	\$ 226,857	\$ 1,230,387

As of December 31, 2005, equity method investments of \$8,717, \$282,189 and \$10,570 are included in the total assets of the Mutual Fund, Institutional and High Net Worth segments, respectively. As of December 31, 2006, equity method investments of \$6,451, \$273,170 and \$13,819 are included in the total assets of the Mutual Fund, Institutional and High Net Worth segments, respectively. As of December 31, 2007, equity method investments of \$8,704, \$755,107 and \$78,679 are included in the total assets of the Mutual Fund, Institutional and High Net Worth segments, respectively.

## 27. Subsequent Events

In the first quarter of 2008, the Company called the outstanding floating rate convertible securities for redemption at their principal amount plus accrued and unpaid interest. In lieu of redemption, substantially all of the holders elected to convert their securities into shares of the Company's common stock and the \$300,000 principal amount was reclassified to stockholders' equity. Pursuant to these conversions and other privately negotiated exchanges, the Company will issue approximately 7.0 million shares of common stock and all of the Company's floating rate convertible securities will be cancelled and retired.

In the first quarter of 2008, the Company repurchased the outstanding senior notes component of its 2004 PRIDES. The repurchase proceeds were used by the original holders to fulfill their obligations under the related forward equity purchase contracts. Pursuant to the settlement of the forward equity purchase contracts and other privately negotiated exchanges, the Company has issued approximately 4.0 million shares of common stock. All of the Company's 2004 PRIDES securities have been cancelled and retired.



Schedule II

Valuation and Qualifying Accounts

(in thousands)	Balance Beginning of Period	Additions Charged to Costs and Expenses	Balance End of Period
Income Tax Valuation Allowance			
Year Ending December 31,			
2007	\$ 14,126	\$ 3,897	\$ 18,023
2006	12,097	2,029	14,126
2005	10,337	1,760	12,097
	78		

**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

As required by Rule 13a-15 under the Exchange Act, as of December 31, 2007, we carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. In designing and evaluating our disclosure controls and procedures, we and our management recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily was required to apply its judgment in evaluating and implementing possible controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. We review on an ongoing basis and document our disclosure controls and procedures, and our internal controls and procedures over financial reporting, and we may from time to time make changes in an effort to enhance their effectiveness and ensure that our systems evolve with our business. See Item 8 for "Management's Report on Internal Control over Financial Reporting."

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended December 31, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. Other Information**

None.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance.**

Information required by this Item will be set forth in our proxy statement for our 2008 Annual Meeting of stockholders (to be filed within 120 days after December 31, 2007) (the "Proxy Statement"), and is incorporated herein by reference.

**Item 11. Executive Compensation.**

Information relating to executive compensation will be set forth in our Proxy Statement, and is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

Information required by this item will be set forth in our Proxy Statement, and is incorporated herein by reference.

**Item 13. Certain Relationships and Related Transactions and Director Independence.**

Information required by this item will be set forth in our Proxy Statement, and is incorporated herein by reference.

**Item 14. Principal Accountant Fees and Services.**

Information relating to principal accountant fees and services will be set forth in our Proxy Statement, and is incorporated herein by reference.

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules**

- (a) (1) Financial Statements: See Item 8 of this Annual Report on Form 10-K.
- (2) Financial Statement Schedule: See Item 8 of this Annual Report on Form 10-K.
- (3) Exhibits: See the Exhibit Index attached hereto and incorporated by reference herein.





**Exhibit Index**

- 3.1 Amended and Restated Certificate of Incorporation(2)
- 3.2 Amendment to Amended and Restated Certificate of Incorporation(10)
- 3.3 Amendment to Amended and Restated Certificate of Incorporation(14)
- 3.4 Amended and Restated By-laws(2)
- 3.5 Certificate of Designations, Preferences and Rights of a Series of Stock(3)
- 4.1 Specimen certificate for shares of common stock of the Registrant(2)
- 4.2 Liquid Yield Option Notes due May 7, 2021 (Zero Coupon-Senior) Purchase Agreement, dated as of May 1, 2001, by and between Affiliated Managers Group, Inc. and Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated(6)
- 4.3 Liquid Yield Option Notes due May 7, 2021 (Zero Coupon-Senior) Indenture, dated as of May 7, 2001, First Union National Bank, Trustee(6)
- 4.4 Liquid Yield Option Notes due May 7, 2021 (Zero Coupon-Senior) Registration Rights Agreement, dated as of May 7, 2001, by and between Affiliated Managers Group, Inc. and Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated(6)
- 4.5 Indenture, dated December 21, 2001, between Affiliated Managers Group, Inc. and First Union National Bank, as Trustee(7)
- 4.6 First Supplemental Indenture, dated December 21, 2001, between Affiliated Managers Group, Inc. and First Union National Bank, as Trustee(7)
- 4.7 Floating Rate Convertible Senior Debentures due February 25, 2033 Purchase Agreement, dated as of February 19, 2003, by and between Affiliated Managers Group, Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated(13)
- 4.8 Floating Rate Convertible Senior Debentures due February 25, 2033 Indenture, dated as of February 19, 2003, The Bank of New York, Trustee(13)
- 4.9 First Supplemental Indenture dated as of February 24, 2006 to the Indenture dated as of May 7, 2001 between Affiliated Managers Group, Inc. and The Bank of New York (as successor to First Union National Bank), as trustee, relating to the Company's Liquid Yield Option Notes due May 7, 2021(17)
- 4.10 Floating Rate Convertible Senior Debentures due February 25, 2033 Purchase Agreement, dated as of February 19, 2003, by and between Affiliated Managers Group, Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated(13)
- 4.11 Purchase Agreement (2004 PRIDES), dated February 6, 2004, by and among Affiliated Managers Group, Inc., Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated(8)
- 4.12 Second Supplemental Indenture, dated February 12, 2004, between Affiliated Managers Group, Inc. and The Bank of New York, as Trustee(8)
- 4.13 Purchase Contract Agreement (2004 PRIDES), dated February 12, 2004, between Affiliated Managers Group, Inc. and The Bank of New York, as Purchase Contract Agent(8)
- 4.14 Pledge Agreement (2004 PRIDES), dated February 12, 2004, between Affiliated Managers Group, Inc. and The Bank of New York, as Collateral Agent, Custodial Agent, Purchase Contract Agent and Securities Intermediary(8)
- 4.15 Remarketing Agreement (2004 PRIDES), dated February 12, 2004, by and among Affiliated Managers Group, Inc., The Bank of New York, as Purchase Contract Agent, and Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated as Remarketing Agent and Reset Agent(8)
- 4.16 Registration Rights Agreement (2004 PRIDES), dated February 12, 2004, by and among Affiliated Managers Group, Inc. and Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated(8)
- 4.17 Form of 4.125% Senior Note (2004 PRIDES) (included as part of Exhibit 4.10)
- 4.18 Form of Income Prides Certificate (2004 PRIDES) (included as Exhibit A to Exhibit 4.11)

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- 4.19 Form of Growth Prides Certificate (2004 PRIDES) (included as Exhibit B to Exhibit 4.11)
- 4.20 Amended and Restated Declaration of Trust of AMG Capital Trust I, dated as of April 3, 2006, among Affiliated Managers Group, Inc., Christiana Bank & Trust Company, as Delaware Trustee, LaSalle Bank National Association, as Property Trustee and the Administrative Trustee named therein(15)
- 4.21 Indenture, dated as of April 3, 2006, between Affiliated Managers Group, Inc. and LaSalle Bank National Association, as Debenture Trustee, including form of 5.10% Junior Subordinated Convertible Debenture due April 15, 2036(15)
- 4.22 Guarantee Agreement, dated as of April 3, 2006, between Affiliated Managers Group, Inc. and LaSalle Bank National Association, as Guarantee Trustee(15)
- 4.23 Amended and Restated Declaration of Trust of AMG Capital Trust II, dated as of October 17, 2007, among Affiliated Managers Group, Inc., LaSalle National Trust Delaware, as Delaware Trustee, LaSalle Bank National Association, as Property Trustee and Institutional Administrator, and the holders from time to time of undivided beneficial interests in the assets of the Trust(16)
- 4.24 Indenture, dated as of October 17, 2007, between Affiliated Managers Group, Inc. and LaSalle Bank National Association, as Debenture Trustee(16)
- 4.25 Guarantee Agreement, dated as of October 17, 2007, between Affiliated Managers Group, Inc. and LaSalle Bank National Association, Guarantee Trustee(16)
- 4.26 Confirmation of Forward Stock Purchase Contract, dated October 12, 2007, between the Affiliated Managers Group, Inc. and Merrill Lynch International and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as agent thereunder(16)
- 10.1 Second Amended and Restated Credit Agreement, dated as of February 8, 2007, by and among Affiliated Managers Group, Inc., Bank of America, N.A., as administrative agent, and the several lenders from time to time parties thereto(18)
- 10.2 Third Amended and Restated Credit Agreement, dated as of November 27, 2007, by and among Affiliated Managers Group, Inc., Bank of America, N.A., as administrative agent, and the several lenders from time to time parties thereto(19)
- 10.3 Affiliated Managers Group, Inc. Defined Contribution Plan(4)
- 10.4 Affiliated Managers Group, Inc. Long-Term Executive Incentive Plan(5)
- 10.5 Affiliated Managers Group, Inc. Amended and Restated 1997 Stock Option and Incentive Plan(9)
- 10.6 Affiliated Managers Group, Inc. Amended and Restated 2002 Stock Option and Incentive Plan(9)
- 10.7 Affiliated Managers Group, Inc. 2006 Stock Option and Incentive Plan(14)
- 10.8 Affiliated Managers Group, Inc. Long-Term Stock and Investment Plan(10)
- 10.9 Affiliated Managers Group, Inc. Executive Retention Plan(11)
- 10.10 Affiliated Managers Group, Inc. Deferred Compensation Plan(20)
- 23.1 Schedule of Subsidiaries(1)
- 31.1 Consent of PricewaterhouseCoopers LLP(1)
- 31.1 Certification of Registrant's Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002(1)
- 31.2 Certification of Registrant's Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002(1)
- 32.1 Certification of Registrant's Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002(1)
- 32.2 Certification of Registrant's Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002(1)

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Indicates a management contract or compensatory plan

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- (1) Filed herewith
- (2) Incorporated by reference to the Company's Registration Statement on Form S-1 (No. 333-34679), filed August 29, 1997, as amended
- (3) Incorporated by reference to the Company's Registration Statement on Form S-3 (No. 333-71561), filed February 1, 1999, as amended
- (4) Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999 (001-13459/99582797)
- (5) Incorporated by reference to the Company's Proxy Statement on Schedule 14A filed April 19, 2000 (001-13459/604839)
- (6) Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed May 15, 2001 (001-13459/1636134)
- (7) Incorporated by reference to the Company's Current Report on Form 8-K filed December 31, 2001 (001-13459/1826505)
- (8) Incorporated by reference to the Company's Current Report on Form 8-K filed February 23, 2004
- (9) Incorporated by reference to the Company's Quarterly Report or Form 10-Q filed May 10, 2004
- (10) Incorporated by reference to the Company's Registration Statement on Form S-8 (No. 333-129748) filed November 16, 2005
- (11) Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed October 9, 2005
- (12) Incorporated by reference to the Company's Current Report on Form 8-K filed January 25, 2006
- (13) Incorporated by reference to the Company's Annual Report on Form 10-K filed March 31, 2003
- (14) Incorporated by reference to the Company's Proxy Statement on Schedule 14A filed April 28, 2006
- (15) Incorporated by reference to the Company's Current Report on Form 8-K filed April 7, 2006
- (16) Incorporated by reference to the Company's Current Report on Form 8-K filed October 18, 2007
- (17) Incorporated by reference to the Company's Current Report on Form 8-K filed February 28, 2006
- (18) Incorporated by reference to the Company's Current Report on Form 8-K filed February 9, 2007
- (19) Incorporated by reference to the Company's Current Report on Form 8-K filed December 3, 2007
- (20) Incorporated by reference to the Company's Current Report on Form 8-K filed July 7, 2006

