AFFILIATED MANAGERS GROUP INC
Form 10-Q
May 10, 2007

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

OR

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

For the transition period from to

Commission File Number 001-13459

Affiliated Managers Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**04-3218510**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

600 Hale Street, Prides Crossing, Massachusetts 01965

(Address of principal executive offices)

(617) 747-3300

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer x   Accelerated Filer o   Non-accelerated Filer o

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

There were 29,790,313 shares of the registrant s common stock outstanding on May 4, 2007.

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

AFFILIATED MANAGERS GROUP, INC.

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share data)

(unaudited)

	For the Three Months Ended March 31, 2006	2007
Revenue	$ 278,042	$ 309,837
Operating expenses:		
Compensation and related expenses	116,517	138,932
Selling, general and administrative	43,483	45,506
Amortization of intangible assets	6,854	7,943
Depreciation and other amortization	1,896	2,365
Other operating expenses	5,586	2,789
	174,336	197,535
Operating income	103,706	112,302
Non-operating (income) and expenses:		
Income from equity method investments	(5,599)	(7,971)
Investment and other income	(3,357)	(4,622)
Investment income from Affiliate investments in partnerships	(10,829)	(2,642)
Interest expense	11,482	18,387
	(8,303)	3,152
Income before minority interest and taxes	112,009	109,150
Minority interest	(45,869)	(48,473)
Minority interest in Affiliate investments in partnerships	(10,203)	(2,547)
Income before income taxes	55,937	58,130
Income taxes current	13,791	13,012
Income taxes intangible-related deferred	7,105	7,032
Income taxes other deferred	(199)	1,464
Net Income	$ 35,240	$ 36,622
Earnings per share basic	$ 1.05	$ 1.23
Earnings per share diluted(1)	$ 0.81	$ 0.93
Average shares outstanding basic	33,681,230	29,698,622
Average shares outstanding diluted(1)	46,307,678	44,600,908
Supplemental disclosure of total comprehensive income:		
Net Income	$ 35,240	$ 36,622
Other comprehensive income (loss)	(465)	3,167
Total comprehensive income	$ 34,775	$ 39,789

(1) See Note 7 for the calculation of diluted earnings per share.

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

AFFILIATED MANAGERS GROUP, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands)

(unaudited)

	December 31, 2006	March 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 201,729	$ 124,084
Investment advisory fees receivable	201,385	178,269
Affiliate investments in partnerships	108,350	108,532
Affiliate investments in marketable securities	15,516	21,968
Prepaid expenses and other current assets	27,299	20,990
Total current assets	554,279	453,843
Fixed assets, net	63,984	65,224
Equity investments in Affiliates	293,440	280,087
Acquired client relationships, net	502,066	489,265
Goodwill	1,177,227	1,180,210
Other assets	74,924	99,456
Total assets	$ 2,665,920	$ 2,568,085
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 246,727	$ 111,574
Payables to related party	41,086	13,606
Total current liabilities	287,813	125,180
Senior debt	365,500	428,500
Senior convertible securities	413,358	408,840
Mandatory convertible securities	300,000	300,000
Junior convertible trust preferred securities	300,000	300,000
Deferred income taxes	218,584	221,605
Other long-term liabilities	11,209	30,234
Total liabilities	1,896,464	1,814,359
Commitments and contingencies (Note 8)		
Minority interest	166,138	135,777
Minority interest in Affiliate investments in partnerships	104,096	104,187
Stockholders equity:		
Common stock	390	390
Additional paid-in capital	609,369	627,167
Accumulated other comprehensive income	14,666	17,833
Retained earnings	654,465	691,087
	1,278,890	1,336,477
Less: treasury stock, at cost	(779,668)	(822,715)
Total stockholders equity	499,222	513,762
Total liabilities and stockholders equity	$ 2,665,920	$ 2,568,085

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

AFFILIATED MANAGERS GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	For the Three Months Ended March 31, 2006	2007
Cash flow used in operating activities:		
Net Income	$ 35,240	$ 36,622
Adjustments to reconcile Net Income to net cash flow used in operating activities:		
Amortization of intangible assets	6,854	7,943
Amortization of issuance costs	663	758
Depreciation and other amortization	1,896	2,365
Deferred income tax provision	6,906	8,496
Accretion of interest	596	708
Income from equity method investments, net of amortization	(5,599)	(7,971)
Distributions received from equity method investments	21,022	20,513
Tax benefit from exercise of stock options	3,010	3,539
Stock option expense	378	2,644
Other adjustments	2	1,153
Changes in assets and liabilities:		
(Increase) decrease in investment advisory fees receivable	(7,448)	23,466
Decrease in Affiliate investments in partnerships		2,173
Decrease in prepaids and other current assets	2,491	791
(Increase) decrease in other assets	3,884	(12,144)
Decrease in accounts payable, accrued liabilities and other long-term liabilities	(32,975)	(109,874)
Decrease in minority interest	(39,003)	(28,521)
Cash flow used in operating activities	(2,083)	(47,339)
Cash flow used in investing activities:		
Cost of investments in Affiliates, net of cash acquired	(9,358)	(25,855)
Purchase of fixed assets	(7,136)	(4,086)
Purchase of investment securities	(6,562)	(12,500)
Sale of investment securities		4,629
Cash flow used in investing activities	(23,056)	(37,812)
Cash flow from (used in) financing activities:		
Borrowings of senior bank debt	107,000	136,000
Repayments of senior bank debt	(63,500)	(73,000)
Issuance of common stock	32,407	35,625
Repurchase of common stock	(69,855)	(109,003)
Issuance costs	(5)	(1,556)
Excess tax benefit from exercise of stock options	11,239	22,340
Cost of call spread option agreements	(13,290)	
Repayments of notes payable and other liabilities	(4,490)	(1,009)
Redemptions of minority interest- Affiliate investments in partnerships		(2,173)
Cash flow from (used in) financing activities	(494)	7,224
Effect of foreign exchange rate changes on cash and cash equivalents	(71)	282
Net decrease in cash and cash equivalents	(25,704)	(77,645)
Cash and cash equivalents at beginning of period	140,423	201,729
Cash and cash equivalents at end of period	$ 114,719	$ 124,084
Supplemental disclosure of non-cash financing activities:		
Notes received for Affiliate equity sales	$ 985	$ 16,431
Payables recorded for Affiliate equity purchases	185	7,505
Stock issued for zero coupon senior convertible note conversions	9,935	4,658

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

4

(in thousands)

AFFILIATED MANAGERS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The consolidated financial statements of Affiliated Managers Group, Inc. (Company or AMG) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all of the disclosures required by accounting principles generally accepted in the United States of America. In the opinion of management, all adjustments considered necessary for a fair statement of the results have been included. All intercompany balances and transactions have been eliminated. All dollar amounts in these notes (except information that is presented on a per share, per security, per note or per contract basis) are stated in thousands, unless otherwise indicated. Certain reclassifications have been made to the prior period s financial statements to conform to the current period s presentation. Operating results for interim periods are not necessarily indicative of the results that may be expected for the full year. The Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2006 includes additional information about AMG, its operations and its financial position, and should be read in conjunction with this Quarterly Report on Form 10-Q.

2. Senior Debt

The Company has a senior revolving credit facility (the Facility) which allows for borrowings of up to $650,000 at rates of interest (based either on the Eurodollar rate or the prime rate as in effect from time to time) that vary depending on the Company s credit ratings. Subject to the agreement of the lenders (or prospective lenders) to increase their commitments, the Company has the option to borrow up to an aggregate of $800,000 under this Facility. 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.

3. Senior Convertible Securities

The components of senior convertible securities are as follows:

	December 31, 2006		March 31, 2007	
Zero coupon senior convertible notes	$	113,358	$	108,840
Floating rate senior convertible securities	300,000		300,000	
	$	413,358	$	408,840

Zero Coupon Senior Convertible Notes

In May 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. Following the repurchase or conversion of an aggregate of $134,231 principal amount of such notes, $116,769 principal amount at maturity of zero coupon convertible notes remains outstanding. Each security is convertible into 17.429 shares of the Company s common stock (at a current base conversion price of $53.41) upon the occurrence of certain events,

5

including the following: (i) if the closing price of a share of its common stock exceeds 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 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 February 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

In February 2003, the Company issued $300,000 of floating rate senior convertible securities due 2033 (floating rate convertible securities). The floating rate convertible securities bear 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 March 31, 2007, upon conversion, a holder of each security would receive an additional 5.626 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 its common stock or some combination thereof. The Company may redeem the convertible securities for cash at any time on or after February 25, 2008, at their principal amount. 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, the floating rate convertible securities may not be convertible in certain future periods.

The Company has interest rate swap contracts that effectively exchange the variable interest rate for a fixed interest rate on $150,000 of the floating rate convertible securities. Through February 2008, the Company will pay a weighted average fixed rate of 3.28% on that notional amount.

4. Mandatory Convertible Securities

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

Each unit of the 2004 PRIDES consists of (i) a senior note due February 2010 with a principal amount of $1,000 per note, on which the Company pays interest quarterly at the annual rate of 4.125%, and (ii) a forward purchase contract pursuant to which the holder has agreed to purchase shares of the Company s common stock in February 2008. Holders of the purchase contracts receive a quarterly contract adjustment payment at the annual rate of 2.525% per $1,000 purchase contract through February 2008, and all of these payments are recorded in current liabilities. 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 March 31, 2007, the purchase contracts would have a settlement rate of 13.140.

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

5. Junior Convertible Trust Preferred Securities

In April 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. Under FASB Interpretation No. 46 (revised), Consolidation of Variable Interest Entities, the trust is not consolidated in the Company s financial statements. The junior subordinated convertible debentures and convertible trust preferred securities (together, the junior convertible trust preferred securities) have substantially the same terms.

The 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. 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 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 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 convertible trust preferred securities receive all payments due from the trust.

6. 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. The adoption of FIN 48 did not result in a material adjustment to the Company s liability for uncertain tax positions. On January 1, 2007 the Company carried a liability for uncertain tax positions of $21,300, including $3,761 for interest and related charges. In the event that all of these liabilities were resolved favorably, the Company would reduce its income tax provision by approximately $11,800, thereby lowering its effective tax rate.

The Company s policy is to include interest and related charges in its income tax provision. 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 U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2003.

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

	For the Three Months Ended March 31,	
	2006	**2007**
Current:		
Federal	$ 9,309	$ 9,060
State	1,674	1,567
Foreign	2,808	2,385
Total Current	$ 13,791	$ 13,012
Deferred:		
Federal	$ 7,091	$ 8,754
State	405	500
Foreign	(590)	(758)
Total Deferred	$ 6,906	$ 8,496
Provision for Income Taxes	$ 20,697	$ 21,508

7

(in thousands) 10

(in thousands)

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

	December 31, 2006	March 31, 2007
Deferred assets (liabilities):		
State net operating loss carryforwards	$ 14,126	$ 15,181
Intangible asset amortization	(170,216)	(172,218)
Non-deductible intangible amortization	(26,946)	(24,937)
Deferred compensation		112
Convertible securities interest	(19,807)	(21,795)
Fixed asset depreciation	(1,956)	(2,358)
Deferred income	(398)	(1,421)
Accrued expenses	739	1,012
	(204,458)	(206,424)
Valuation allowance	(14,126)	(15,181)
Net deferred income taxes	$ (218,584)	$ (221,605)

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. The intangible assets associated with the Company s investments in its Canadian Affiliates are not deductible for tax purposes, but certain of these assets are amortized for book purposes. At the time of its investment in these Affiliates, 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 generate tax deductions that are higher than the interest expense recorded for financial statement purposes.

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

7. Earnings Per Share

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

	For the Three Months Ended March 31, 2006	For the Three Months Ended March 31, 2007
Numerator:		
Net Income	$ 35,240,000	$ 36,622,000
Interest expense on convertible securities, net of taxes	2,278,000	5,073,000
Net Income, as adjusted	$ 37,518,000	$ 41,695,000

	For the Three Months Ended March 31,	
	2006	**2007**
Denominator:		
Average shares outstanding basic	33,681,230	29,698,622
Effect of dilutive instruments:		
Stock options	2,630,276	2,314,707
Senior convertible securities	9,448,476	9,353,666
Mandatory convertible securities	547,696	1,233,913
Junior convertible trust preferred securities		2,000,000
Average shares outstanding diluted	46,307,678	44,600,908

The calculation of diluted earnings per share for the three months ended March 31, 2006 and 2007 excludes the effect of the call spread option agreements and the potential exercise of options to purchase approximately 0.1 and 1.0 million common shares, respectively, because their effect would be anti-dilutive.

As more fully discussed in Notes 3 and 5, the Company had convertible securities outstanding during the three months ended March 31, 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 three months ended March 31, 2006 and 2007, the Company repurchased approximately 0.7 and 0.9 million shares, respectively, of common stock under various stock repurchase programs.

8. 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.

Many of the Company s operating agreements provide Affiliate management partners the conditional right to require the Company to purchase their retained equity interests at certain intervals. These agreements also provide the Company the conditional right to require Affiliate management partners to sell their retained equity interests upon their death, permanent incapacity or termination of employment and provide such partners the conditional right to require the Company to purchase such interests upon the occurrence of such events. These purchases are generally calculated based upon a multiple of the Affiliate s cash flow distributions, which is intended to represent fair value. As one measure of the potential magnitude of such purchases, in the event that a triggering event and resulting purchase occurred with respect to all such retained equity interests as of March 31, 2007, the aggregate amount of these payments would have totaled approximately $1,444,800. In the event that all such transactions were closed, the Company would own the cash flow distributions attributable to the additional equity interests purchased from Affiliate management partners. As of March 31, 2007, this amount would represent approximately $183,400 on an annualized basis. The partners are also permitted to sell their equity interests to other individuals or entities in certain cases, subject to the Company s approval or other restrictions.

9

(in thousands) 13

9. Affiliate Investments in Partnerships

Several of the Company s Affiliates are general partners in investment partnerships. Under 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), a general partner is required to consolidate 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. If the general partner does not control a partnership, it is required to account for its interest in the partnership using the equity method of accounting.

Assets of the consolidated partnerships are reported as Affiliate investments in partnerships. Substantially all 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 that is attributable to investors that are unrelated to the Company is reported as a Minority interest in Affiliate investments in partnerships. During the three months ended March 31, 2006 and 2007 the partnerships purchased investments (principally equity securities) totaling $29,835 and $46,531, respectively, and sold investments totaling $29,835 and $48,704, respectively. In addition, during the three months ended March 31, 2007 the partnerships had client subscriptions of $2,826 and client redemptions of $4,999.

As of December 31, 2006 and March 31, 2007, the Company s investments in partnerships that are not controlled by its Affiliates were $21,449 and $30,158, 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.

10. Affiliate Investments in Marketable Securities

Affiliate investments in marketable securities are classified as either trading or available-for-sale securities 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.

The cost of Affiliate investments in marketable securities was $14,342 and $20,985 as of December 31, 2006 and March 31, 2007, respectively. Gross unrealized gains on these investments were $1,379 and $1,163 as of December 31, 2006 and March 31, 2007, respectively.

11. Related Party Transactions

The Company periodically records amounts payable to Affiliate partners in connection with the purchase of additional Affiliate equity interests. The total amount payable to Affiliate partners as of March 31, 2007 was $14,884, of which $13,606 is due within one year and reported as a current liability.

The Company records notes receivable from Affiliate partners in connection with the transfer of Affiliate equity interests. The total amount due from Affiliate partners as of March 31, 2007 was $37,017.

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.

12. Equity-Based Compensation Plans

The following table summarizes the transactions of the Company s stock option and incentive plans for the three months ended March 31, 2007:

	Stock Options	Weighted Average Exercise Price	Weighted Avg. Remaining Contractual Life (years)
Unexercised options outstanding January 1, 2007	7,404,822	$ 50.49	
Options granted	85,000	106.58	
Options exercised	(953,651)	37.68	
Options forfeited	(71,053)	91.03	
Unexercised options outstanding March 31, 2007	6,465,118	52.67	5.0
Exercisable at March 31, 2007	5,458,605	43.61	4.8
Exercisable and free from restrictions on transfer at March 31, 2007	4,254,490	40.18	4.0

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 three months ended March 31, 2007 was $25.45, based on the assumptions stated below.

	For the Three Months Ended March 31, 2007
Dividend yield	0.0 %
Expected volatility(1)	22.9 %
Risk-free interest rate(2)	4.4 %
Expected life of options (in years)(3)	3.5
Forfeiture rate(3)	5.0 %

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(1) Based on the 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.

The Company s Net Income for the three months ended March 31 2007 includes $1,666 of compensation expense, and $978 of income tax benefits, related to our equity-based compensation arrangements. As of March 31, 2007, there was $28,301 of deferred compensation expense related to stock options, which is expected to be recognized over a weighted average period of approximately three years (assuming no forfeitures).

13. Call Spread Option Agreements

In March 2006, the Company entered into a series of call spread option agreements with a major securities firm. The agreements provide the Company the option, but not the obligation, to repurchase up to 917,000 shares of its common stock, beginning in June 2007 and ending in December 2007, at a weighted-average price of $99.59 per share. If the Company s prevailing share price exceeds $132.74 on a weighted-average basis during this period, the net number of shares available for repurchase under the agreements will be reduced.

In the event the Company exercises its option, the Company may elect to receive cash proceeds rather than shares of common stock. In connection with these agreements, the Company made payments of $13,290, which were recorded as a reduction of stockholders equity.

14. 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.

(in thousands) 15

11

(in thousands)

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

Statements of Income

	For the Three Months Ended March 31, 2006			
	Mutual Fund	**Institutional**	**High Net Worth**	**Total**
Revenue	$ 121,214	$ 119,794	$ 37,034	$ 278,042
Operating expenses:				
Depreciation and other amortization	1,659	5,043		