

Fiscal 1977 was a difficult and challenging year for The Becker Warburg Paribas Group. Although our financial results were disappointing, the Group's business continued to advance toward longer range objectives. Revenues for the year totalled \$118,419,000 compared with \$135,374,000 in fiscal 1976. Net income amounted to \$937,000 versus \$7,527,000 in the previous fiscal year.

Several factors combined to bring strong pressure on profitability during the year. Price competition in the stock exchange commission business increased as sluggish volume and declining equity values dominated investors' attitudes. Successful operations in the money and bond markets were inhibited by a pattern of increasing interest rates and reduced financing by issuers. Uncertainty continued as to the future structure of the equity securities marketplace; even as we enter 1978, many questions remain unresolved. All of these conditions persisted through 1977 against a background of eroding confidence in national economic and international monetary policies.

Despite these conditions, The Becker Warburg Paribas Group successfully provided a wide range of professional capital and money market services to securities issuers and investors in the United States and overseas.

Warburg Paribas Becker, which conducts the Group's investment banking operations, accelerated its growth and expanded its services. Despite the significant reduction in the total amount of corporate financing carried out in the U.S. during the year, private financings handled by Warburg Paribas Becker exceeded \$1 billion, and total public and private financings managed or co-managed increased to more than \$2.5 billion. Corporate merger and acquisition services also were active during the year.

A. G. Becker continued in its role as a leading factor in the fixed income securities markets. In general, market share was maintained and overall marketing strength was increased to meet future demands and opportunities. Shortly after the close of the fiscal year, new A. G. Becker offices were opened in Cleveland and San Juan to serve fixed-income securities clients in those areas.

Becker Securities' activities were significantly affected by intense price competition and adverse market conditions in the equity markets. Services to individual investor clients, however, were broadened in the area of corporate and municipal bond services. Trading services were reorganized and expanded, including the initiation of OTC equity market operations as a dealer and market maker. The Becker funds evaluation service experienced steady growth as the conversion to a cash fee basis neared completion. And finally, steady development of our market maker clearing services was achieved.

Shortly after the close of fiscal 1977, David G. Scholey, Deputy Chairman of S. G. Warburg & Co. Ltd., and Pierre Haas, Executive Vice President of Banque de Paris et des Pays-Bas, were elected Co-Chairmen of the Group. In addition, Michel Francois-Poncet, Senior Vice President of the Banque de Paris et des Pays-Bas, was elected a Director. We are fortunate to have both former Co-Chairmen, Pierre Moussa and Geoffrey C. Seligman, continue as Directors.

Looking ahead, recent national and international economic developments, if extended, are certain to be unsettling. Financial markets are likely to remain uneasy and investors and issuers cautious. Thus, we do not foresee the 1978 environment to be any more favorable than that of 1977.

In the broader time perspective, however, there continues to be substantial evidence that the demand for professional capital market services by investors in, and issuers of, dollar denominated securities – especially in the U.S. – will be growing substantially over the next five to ten years. The number of leading firms offering such services is shrinking, and those remaining are going to be the larger, diversified organizations like The Becker Warburg Paribas Group. While not taking our eyes and efforts off the near-term problems we face, we continue to believe that the longer-term outlook holds challenging opportunities.

January 25, 1978

Auditors' Report

To the Board of Directors
and Stockholders of
The Becker Warburg Paribas
Group Incorporated:

We have examined the consolidated balance sheet of THE BECKER WARBURG PARIBAS GROUP INCORPORATED (a Delaware corporation) AND SUBSIDIARIES as of October 28, 1977. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note 1 to the consolidated balance sheet, investment securities which are not readily marketable have been valued at estimated fair value. We have reviewed the procedures applied by management in valuing such investments and have inspected underlying documentation; while in the circumstances the procedures appear to be reasonable and the documentation appropriate, determination of fair value involves subjective judgment which is not susceptible to substantiation by auditing procedures.

In our opinion, subject to the effect of the valuation of certain investment securities by management as described in the preceding paragraph, the aforementioned balance sheet presents fairly the financial position of The Becker Warburg Paribas Group Incorporated and Subsidiaries as of October 28, 1977, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

ARTHUR ANDERSEN & CO.

Chicago, Illinois,
December 16, 1977.

Consolidated Balance Sheet

October 28, 1977 (000 omitted)

Assets

| | |
|---|--------------------|
| Cash | \$ 14,054 |
| Deposits with clearing organizations | \$ 6,859 |
| Money market instruments and trading securities, at market (Notes 4 and 13) — | |
| Certificates of deposit | \$ 440,888 |
| Commercial paper | 311,152 |
| Bankers' acceptances | 92,865 |
| U.S. Government obligations | 73,315 |
| Corporate securities | 70,234 |
| Municipal securities | 4,426 |
| | <u>\$ 992,880</u> |
| Money market instruments and trading securities purchased under agreements to resell (Note 5) | \$ 344,262 |
| Receivables from customers, less reserve of \$352,000 | 203,161 |
| Receivables from brokers and dealers | 65,531 |
| Accrued interest, syndicate settlements, dividends, floor brokerage and other receivables | 13,964 |
| Investment securities, at estimated fair value — cost \$4,007,000 | 5,333 |
| Exchange memberships, at adjusted cost — market \$1,240,000 | 1,066 |
| Equipment and leasehold improvements, at cost, less accumulated depreciation and amortization of \$4,464,000 (Note 4) | 5,820 |
| Other assets | 903 |
| | <u>\$1,653,833</u> |

The accompanying notes are an integral part of this statement.

Liabilities and Stockholders' Equity

| | |
|---|--------------------|
| Money market instruments and trading securities sold under agreements to repurchase (Note 5) | \$ 933,680 |
| Collateral loans (Note 4) | 192,100 |
| Securities sold, not yet purchased, at market | 257,202 |
| Payables to brokers and dealers | 57,464 |
| Payables to customers | 107,335 |
| Accounts payable and accrued liabilities | 35,590 |
| | <u>\$1,583,371</u> |
| Senior term credit note (Note 7) | <u>\$ 3,000</u> |
| Subordinated liabilities — | |
| Senior term loan of subsidiary (Note 8) | \$ 5,000 |
| Other (Note 9) | 21,332 |
| Total subordinated liabilities | <u>\$ 26,332</u> |
| Stockholders' equity — | |
| Common stock (Note 10) | \$ 288 |
| Additional paid-in capital | 13,376 |
| Retained earnings (Notes 8 and 12) | 49,908 |
| | <u>\$ 63,572</u> |
| Less — | |
| Treasury stock, at cost | 19,295 |
| Notes due from stockholders (Note 11) | 3,147 |
| Total stockholders' equity | <u>\$ 41,130</u> |
| Total subordinated liabilities and stockholders' equity | <u>\$ 67,462</u> |
| | <u>\$1,653,833</u> |

(1) Accounting Policies:

(a) The consolidated balance sheet includes the accounts of The Becker Warburg Paribas Group Incorporated (BWP) and its subsidiary companies, all of which are wholly owned. All material intercompany accounts and transactions are eliminated. Foreign currency items are translated into U.S. dollars at year-end exchange rates.

(b) Money market instruments and trading securities are held for resale to customers and are valued at market. Money market instruments sold under delayed delivery contracts are valued at amortized cost, which will be equivalent to subsequent sales price.

(c) Investment securities generally represent long-term investments in securities which are carried at estimated fair value as determined by management. Investment securities amounting to \$3,107,000 as of October 28, 1977, were not readily marketable. In the determination of estimated fair value, the following guidelines are observed:

(i) Marketable securities are valued at the quoted market price or at quoted market less an appropriate discount when it is felt that the public market cannot absorb the entire position at the quoted market price.

(ii) Restricted securities are valued at the quoted market price of their marketable equivalents, less an appropriate discount.

(iii) When an objective measure of fair value is not readily obtainable due to nonmarketability, estimated fair value is measured by bona fide sales of the same securities or similar securities by the same issuer, application of an earnings multiple or other significant factors.

(d) Money market instrument and security transactions and related revenues and expenses are recorded in the accounts on settlement date.

(e) The Company's fiscal year ends on the last Friday of October.

(f) Exchange memberships are carried at cost, adjusted for permanent impairment in value.

(g) Office equipment is depreciated over a ten-year period using the sum of the years-digits method. Data processing equipment is depreciated over a six-year period using the straight-line method. Leasehold improvements are amortized over the lesser of the estimated economic life of the improvements or the remaining lease term.

(h) Income tax expense is computed on reported income adjusted for permanent differences in computing taxes payable under applicable tax laws.

Certain income or expense items are accounted for in different periods for financial reporting purposes than for income tax purposes. Appropriate provisions are made for deferred taxes in recognition of these timing differences. The investment tax credit is accounted for as a reduction of the provision for income taxes in the year realized.

(i) Provision is made for net unrealized losses on contractual commitments.

(2) Name Change:

In June, 1977, The Becker and Warburg-Paribas Group Incorporated changed its name to The Becker Warburg Paribas Group Incorporated.

(3) Voting Trust:

Becker Securities Incorporated (BSI), a wholly owned subsidiary, is engaged in business as a member firm of the New York Stock Exchange, Inc. The capital stock of BSI is held by a voting trust which vests the voting power of BSI's capital stock in voting trustees. The Amalgamation Agreement (see Note 10) provides that the stock of BSI will be held by voting trustees as long as BSI is engaged in business as a member firm of the New York Stock Exchange, Inc. or any other national securities exchange and the constitution or rules of any such exchange restrict control by foreign parties over the management or policies of its member firms.

(4) Collateral Loans:

Collateral loans of \$190,712,000 represent borrowings payable on demand made at the market rate of interest to brokers and dealers. At October 28, 1977, the Company had pledged \$132,275,000 of firm-owned money market instruments and trading securities to secure collateral loans of \$118,183,000. In addition, \$1,388,000 was collateralized by data processing equipment with a carrying value of \$1,296,000 and is payable in nine equal semiannual installments beginning September 15, 1978.

(5) Repurchase Agreements:

Repurchase agreements consist of the sale of money market instruments and trading securities with an agreement to repurchase at a future date. As of October 28, 1977, the market value of money market instruments and trading securities covered by such agreements was \$933,000,000. Of this amount, \$155,000,000 was purchased under agreements to resell at a future date.

(6) Pension Plan:

The Company has a noncontributory pension plan covering substantially all of its employees. The net assets of the pension fund exceeded the actuarially computed value of the vested benefits as of October 28, 1977. Pension expense includes normal cost plus amortization of unfunded past-service costs over 40 years. The general policy is to fund pension costs accrued.

(7) Senior Term Credit Note:

In 1976, the Company entered into a \$10,000,000 Revolving Credit Agreement

with a bank, which expires December 31, 1978. As of October 28, 1977, the Company borrowed \$3,000,000 under this agreement which matures December 31, 1978, and bears interest at 125% of the bank's prime rate plus 3/8 of 1%. This note is collateralized by a \$5,000,000 subordinated note issued to BWP by one of its wholly owned subsidiaries. The note is senior to all indebtedness of the Company. Under the terms of the agreement, the Company must maintain consolidated net worth of \$32,000,000. Any indebtedness outstanding as of December 31, 1978, may be converted to a term loan payable in six equal semiannual installments beginning June 30, 1979.

(8) Senior Subordinated Term Loan of Subsidiary:

The senior subordinated term loan of BSI was borrowed under a \$5,000,000 commitment with a bank, which expires December 27, 1978, and bears interest at 125% of the greater of the bank's base rate on 90-day loans to responsible and substantial commercial borrowers in effect from time to time or one half of one percent above an alternative rate (as defined in the agreement) through December 27, 1977, and 130% of the greater of the aforementioned rates thereafter. The loan is senior to all other subordinated borrowings of BSI and is not a liability of BWP or any other BWP subsidiary.

This loan is payable in four equal semiannual installments beginning June 27, 1979. Under the terms of the senior subordinated term loan agreement as amended, BSI is required, among other things, to maintain net worth of at least \$12,800,000 and "net capital" of not less than 7% of "aggregate debit items" and a ratio of "net capital to allowable capital" of at least 40% (as those terms are defined). As of October 28, 1977, BSI had a net worth of \$18,458,000, net capital of \$19,993,000, which was equal to 10.5% of aggregate debit items pursuant to SEC Rule 15c3-3, and a ratio of "net capital to allowable capital" (as defined) of 58.9%.

(9) Other Liabilities Subordinated to the Claims of General Creditors:

Below is a summary of subordinated liabilities of BWP as of October 28, 1977, (000 omitted):

| | |
|--|----------|
| Capital note | \$18,000 |
| Cash subordination agreements (amounts payable under deferred compensation agreements) | 1,165 |
| Junior subordinated debentures | 2,167 |
| | \$21,332 |

The capital note, which bears interest at the rate of 10%, will mature when the Company's earnings allocable to Class A and Class B shares aggregate \$20,000,000 after October 25, 1974, but not later than October 31, 1980.

Subordinated deferred compensation bears interest at the rate of 8% and is payable in annual installments. Deferred compensation of \$141,000 has an indefinite maturity and the remainder matures in 1983. Under the terms of the cash subordination agreements, either the Company or the lender may terminate the agreement upon giving six months' prior written notice.

Junior subordinated debentures arise from the purchase by the Company of a stockholder's shares when he ceases to be an officer or employee (See Note 11) and bear interest at rates varying from 7½% to 9%.

(10) Common Stock:

The Company has outstanding three classes of \$.10 par value common stock, each of which is divided into a series of voting stock and nonvoting stock and is described as follows:

| Description | Shares | | |
|-------------|------------|-----------|-------------|
| | Authorized | Issued | Outstanding |
| Class A – | | | |
| Voting | 1,600,000 | 1,564,920 | 1,088,662 |
| Nonvoting | 400,000 | 111,090 | 108,847 |
| Class B – | | | |
| Voting | 2,600,000 | 282,819 | 282,819 |
| Nonvoting | 650,000 | 24,475 | 24,475 |
| Class C – | | | |
| Voting | 1,000,000 | 881,162 | 208,149 |
| Nonvoting | 250,000 | 21,656 | 20,811 |

In March, 1977, the Company paid a stock dividend of one share of Class A, B or C nonvoting stock for every ten shares of Class A, B or C voting stock issued and outstanding as of February 2, 1977.

Effective July 3, 1974, the Company entered into an Amalgamation Agreement (Agreement) with S. G. Warburg & Co. Ltd. (Warburg), Paribas International (Paribas) and Warburg-Paribas (W-P). W-P is jointly owned by Warburg and Paribas. Pursuant to the Agreement, 138,346 Class A voting and 13,835 Class A nonvoting shares have been issued and placed in escrow pending the resolution of certain claims of the Company outstanding as of December 27, 1974. Ultimately, such shares will be issued to Class A holders as of December 27, 1974, as an adjustment of the terms of the Agreement or will be returned to the Company and canceled. W-P owns all outstanding Class B shares. Upon termination of the escrow, in order to prevent dilution of the equity ratios contemplated in the Agreement, W-P will purchase an additional number of shares of Class B stock equal to 25% of the number of escrow shares not canceled.

The Agreement provides that, subject to certain conditions, including regulatory approval, W-P will acquire a number of shares which will bring its ownership to 50% of the then outstanding voting stock of the Company. This acquisition will occur when the Company's earnings allocable to Class A and B shares aggregate \$20,000,000 after October 25, 1974, but not later than October 31, 1980. Such shares will be acquired by means of purchases from shareholders and/or from the Company. Thereafter, W-P may, under certain conditions, acquire or make a tender offer for additional shares.

The Agreement also provides that all shares sold by the Company to employees subsequent to December 27, 1974, will be Class C shares. Immediately prior to the additional acquisition by W-P, the Company will acquire from W-P one share

of Class B stock for every four shares of Class A acquired by the Company through that date at various prices as determined by the Agreement. As of October 28, 1977, the Company was committed to purchase 45,952 shares of Class B stock at a cost of \$1,368,000.

(11) Stockholder Agreements:

Under various agreements, the Company sells stock to its officers and employees at net asset value, as defined. These agreements provide for the purchase by the Company of a stockholder's shares when he ceases to be an officer or employee. Certain officers, who have been designated by the Board of Directors as employed in a "senior managerial capacity," are entitled to purchase common stock under management share agreements. These management share agreements, which are subject to certain conditions other than those agreements governing the regular sale of the Company's stock, provide for payment of 10% in cash and a 15-year note. The balances on these notes mature in varying amounts in the years 1980 through 1991. At October 28, 1977, there were 109 of these notes outstanding, resulting from the sale of 146,267 and 73,403 shares of Class A and Class C common stock, respectively. These notes bear interest at rates varying from 5% to 8%.

(12) Net Capital Requirements:

Certain of the Company's domestic subsidiaries are subject to the uniform net capital rule promulgated by the SEC. BSI has elected to comply with the alternative capital computation provided in the rule and must maintain net capital equal to 4% of "aggregate debit items" (as those terms are defined by the rule). Also, as a member of the New York Stock Exchange, Inc., BSI is subject to the Exchange's Growth and Business Reduction Capital Requirements. Under such rules, a member firm must reduce its business if net capital is less than 6% of aggregate debit items and its expansion may be restricted if net capital is less than 7% of aggregate debit items. Refer to Note 8 for BSI's capital position as of October 28, 1977. Pursuant to the uniform net capital rule, the ratio of "aggregate indebtedness" to "net capital" of certain other domestic subsidiaries must not exceed 15 to 1 (as those terms are defined by that rule). As of October 28, 1977, the net capital ratio was less than 5 to 1 for all subsidiaries computing the ratio.

(13) Commitments:

In the normal course of business, certain subsidiaries of the Company enter into underwriting and delayed delivery commitments. Open underwriting and delayed delivery commitments as of October 28, 1977, were approximately \$1,138,251,000.

Primarily as a hedging vehicle, a subsidiary of the Company had entered into commercial paper and Treasury bill futures transactions with an underlying market value of \$830,737,000.

As of October 28, 1977, a subsidiary of the Company had entered into "matched repurchase" agreements at contract amounts aggregating \$541,553,000, which are not reflected in the accompanying balance sheet. A matched repurchase agreement consists of a purchase of money market instruments and trading securities with an agreement to resell at a specific future date and a sale of the

same instrument with an agreement to repurchase at the same future date. The principal amount of the contract prices of the purchase-resale and the sale-repurchase are all equal in amount.

The Company conducts its operations using leased facilities, equipment, furniture and fixtures. All leases are accounted for as operating leases. Management expects that, in the normal course of business, leases will be renewed or replaced by other leases.

The minimum rental commitments under noncancelable leases of the Company and its subsidiaries are as follows:

| Fiscal year ending on the last Friday of October— | |
|--|---------------------|
| 1978 | \$ 4,573,000 |
| 1979 | 4,055,000 |
| 1980 | 3,357,000 |
| 1981 | 3,088,000 |
| 1982 | 3,033,000 |
| Subsequent to 1982 | 14,728,000 |
| Total | \$32,834,000 |

(14) Contingent Liabilities:

Under the terms of the Amalgamation Agreement, the Company and its subsidiaries are responsible for certain contingent liabilities of the former A. G. Becker & Co. Incorporated (Becker). In this regard, Becker is a defendant in several lawsuits, and the Company and its subsidiaries are responsible for contingent liabilities arising out of this litigation. Including these litigations, the Company or its subsidiaries are a defendant in five class actions. Class actions, which are frequently brought for the alleged benefit of a large number of plaintiffs, name many securities dealers as defendants and typically seek large amounts in damages. The Company and its subsidiaries also are defendants in other litigation. In the present opinion of management, after considering the advice of legal counsel, these actions will have no material adverse effect on the Company's financial position.

At October 28, 1977, a subsidiary of the Company was contingently liable on security drafts deposited for immediate credit of approximately \$8,625,000.

A subsidiary company had obtained \$29,000,000 in letters of credit and had utilized \$16,102,000 of these letters of credit to meet margin requirements of a clearing organization as of October 28, 1977.

Board of Directors

- Pierre Haas**, Co-Chairman (Paris)
Executive Vice President, Banque de Paris et des Pays-Bas
- David G. Scholey**, Co-Chairman (London)
Deputy Chairman, S. G. Warburg & Co. Ltd.
- William M. Cockrum** (Los Angeles)
Senior Vice President, The Becker Warburg Paribas Group Incorporated
- Peter S. Darling** (London)
Vice Chairman, S. G. Warburg & Co. Ltd.
- John F. Donahue, Jr.** (New York)
President and Chief Operating Officer, A. G. Becker Incorporated
- Edward F. Dugan** (New York)
President and Chief Operating Officer, Warburg Paribas Becker Incorporated
- Geoffrey K. Elliott** (London)
Senior Director, S. G. Warburg & Co. Ltd.
- Michel Francois-Poncet** (Paris)
Senior Vice President, Banque de Paris et des Pays-Bas
- Paul R. Judy** (Chicago)
President and Chief Executive Officer, The Becker Warburg Paribas Group Incorporated
- Frederick Moss** (New York)
Chairman, Becker Securities Incorporated
- Pierre Moussa** (Paris)
President and Chief Operating Officer, Banque de Paris et des Pays-Bas
- Rudolph A. Peterson** (San Francisco)
Chairman of the Policy Committee, The Becker Warburg Paribas Group Incorporated
- Herve Pinet** (Paris)
Executive Vice President, Banque de Paris et des Pays-Bas
- Geoffrey C. Seligman** (London)
Deputy Chairman and Chief Executive Officer, S. G. Warburg & Co. Ltd.
- Ira T. Wender** (New York)
Senior Partner, Wender, Murase & White
- John A. Wing** (Chicago)
President and Chief Operating Officer, Becker Securities Incorporated

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