LEGG MASON, INC.
Form 10-Q
November 06, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 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 September 30, 2014
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: 1-8529

LEGG MASON, INC.
(Exact name of registrant as specified in its charter)

MARYLAND	52-1200960
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
100 International Drive - Baltimore, MD	21202
(Address of principal executive offices)	(Zip code)

(410) 539-0000
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes X No

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 X		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	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 X

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

114,109,608 shares of common stock as of the close of business on October 31, 2014.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

LEGG MASON, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)
(Unaudited)

	September 30, 2014	March 31, 2014
ASSETS		
Current Assets		
Cash and cash equivalents	$658,974	$858,022
Cash and cash equivalents of consolidated investment vehicles	1,530	56,372
Restricted cash	9,158	13,455
Receivables:		
Investment advisory and related fees	344,394	348,633
Other	57,689	68,186
Investment securities	414,923	467,726
Investment securities of consolidated investment vehicles	49,931	50,463
Deferred income taxes	180,239	186,147
Other	96,258	47,677
Other assets of consolidated investment vehicles	826	31,702
Total Current Assets	1,813,922	2,128,383
Fixed assets, net	182,091	189,241
Intangible assets, net	3,170,628	3,171,773
Goodwill	1,231,335	1,240,523
Investments of consolidated investment vehicles	32,229	31,810
Deferred income taxes	166,843	165,705
Other	157,809	183,706
Other assets of consolidated investment vehicles	175	208
TOTAL ASSETS	$6,755,032	$7,111,349
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Current Liabilities		
Accrued compensation	$261,443	$425,466
Accounts payable and accrued expenses	210,495	214,819
Current portion of long-term debt	219	438
Other	107,399	91,586
Debt and other current liabilities of consolidated investment vehicles	2,425	88,936
Total Current Liabilities	581,981	821,245
Deferred compensation	51,790	49,618
Deferred income taxes	290,461	265,583
Other	147,500	166,209
Long-term debt	1,052,062	1,038,826
TOTAL LIABILITIES	2,123,794	2,341,481

Commitments and Contingencies (Note 9)

REDEEMABLE NONCONTROLLING INTERESTS	47,449	45,144
STOCKHOLDERS' EQUITY		
Common stock, par value $.10; authorized 500,000,000 shares; issued 114,510,328 shares in September 2014 and 117,173,639 shares in March 2014	11,451	11,717
Additional paid-in capital	2,990,044	3,148,396
Employee stock trust	(31,114)	(29,922)
Deferred compensation employee stock trust	31,114	29,922
Retained earnings	1,565,983	1,526,662
Accumulated other comprehensive income, net	16,311	37,949
TOTAL STOCKHOLDERS' EQUITY	4,583,789	4,724,724
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$6,755,032	$7,111,349

See Notes to Consolidated Financial Statements

LEGG MASON, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
OPERATING REVENUES				
Investment advisory fees:				
Separate accounts	$204,739	$191,645	$409,509	$382,679
Funds	389,238	372,679	770,865	743,150
Performance fees	13,993	17,346	30,296	39,367
Distribution and service fees	94,481	86,202	184,197	171,081
Other	1,444	1,980	2,909	3,992
Total Operating Revenues	703,895	669,852	1,397,776	1,340,269
OPERATING EXPENSES				
Compensation and benefits	303,878	294,272	609,384	590,383
Distribution and servicing	155,100	155,142	303,808	325,330
Communications and technology	44,624	39,968	86,574	78,367
Occupancy	22,710	24,922	49,667	51,731
Amortization of intangible assets	464	3,624	1,359	7,248
Other	46,764	45,558	97,083	97,310
Total Operating Expenses	573,540	563,486	1,147,875	1,150,369
OPERATING INCOME	130,355	106,366	249,901	189,900
OTHER NON-OPERATING INCOME (EXPENSE)				
Interest income	1,680	1,371	4,205	3,010
Interest expense	(14,975)	(12,859)	(32,033)	(25,927)
Other income (expense), net, including $107,074 debt extinguishment loss in July 2014	(108,156)	9,662	(101,908)	9,747
Other non-operating income (loss) of consolidated investment vehicles, net	(79)	2,311	2,928	5,008
Total Other Non-Operating Income (Expense)	(121,530)	485	(126,808)	(8,162)
INCOME BEFORE INCOME TAX PROVISION	8,825	106,851	123,093	181,738
Income tax provision	3,804	19,153	44,460	44,945
NET INCOME	5,021	87,698	78,633	136,793
Less: Net income attributable to noncontrolling interests	124	1,410	1,548	2,690
NET INCOME ATTRIBUTABLE TO LEGG MASON, INC.	$4,897	$86,288	$77,085	$134,103
NET INCOME PER SHARE ATTRIBUTABLE TO LEGG MASON, INC. SHAREHOLDERS:				
Basic	$0.04	$0.70	$0.66	$1.08
Diluted	$0.04	$0.70	$0.66	$1.08

WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING				
Basic	115,799	122,974	116,459	124,095
Diluted	116,940	123,207	117,574	124,308
DIVIDENDS DECLARED PER SHARE	$0.16	$0.13	$0.32	$0.26

See Notes to Consolidated Financial Statements

LEGG MASON, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Dollars in thousands)
(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
NET INCOME	$5,021	$87,698	$78,633	$136,793
Other comprehensive income (loss):				
Foreign currency translation adjustment	(32,240)	10,350	(21,524)	(15,092)
Unrealized gains (losses) on investment securities:				
Unrealized holding losses, net of tax benefit of $0, $(5), $(3) and $(98), respectively	—	(7)	(5)	(148)
Reclassification adjustment for losses included in net income	—	5	5	11
Net unrealized losses on investment securities	—	(2)	—	(137)
Unrealized gains (losses) on reverse treasury rate lock, net of tax provision (benefit) of $(262) and $233, respectively	(368)	—	405	—
Reclassification for realized gain on termination of reverse treasury rate lock, net of tax provision of $(233)	(405)	—	(405)	—
Reclassification for assets held for sale	—	—	(114)	—
Total other comprehensive income (loss)	(33,013)	10,348	(21,638)	(15,229)
COMPREHENSIVE INCOME (LOSS)	(27,992)	98,046	56,995	121,564
Less: Comprehensive income attributable to noncontrolling interests	124	1,410	1,548	2,690
COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO LEGG MASON, INC.	$(28,116)	$96,636	$55,447	$118,874

See Notes to Consolidated Financial Statements

LEGG MASON, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Dollars in thousands)
(Unaudited)

	Six Months Ended September 30, 2014	2013
COMMON STOCK		
Beginning balance	$11,717	$12,534
Stock options and other stock-based compensation	50	47
Deferred compensation employee stock trust	3	4
Deferred compensation, net	98	104
Employee tax withholdings by settlement of net share transactions	(46)	(43)
Shares repurchased and retired	(371)	(532)
Ending balance	11,451	12,114
ADDITIONAL PAID-IN CAPITAL		
Beginning balance	3,148,396	3,449,190
Stock options and other stock-based compensation	17,376	21,815
Deferred compensation employee stock trust	1,707	1,236
Deferred compensation, net	23,601	24,726
Employee tax withholdings by settlement of net share transactions	(21,386)	(13,410)
Shares repurchased and retired	(179,650)	(179,415)
Ending balance	2,990,044	3,304,142
EMPLOYEE STOCK TRUST		
Beginning balance	(29,922)	(32,623)
Shares issued to plans	(1,710)	(1,240)
Distributions and forfeitures	518	3,442
Ending balance	(31,114)	(30,421)
DEFERRED COMPENSATION EMPLOYEE STOCK TRUST		
Beginning balance	29,922	32,623
Shares issued to plans	1,710	1,240
Distributions and forfeitures	(518)	(3,442)
Ending balance	31,114	30,421
RETAINED EARNINGS		
Beginning balance	1,526,662	1,304,259
Net Income Attributable to Legg Mason, Inc.	77,085	134,103
Dividends declared	(37,764)	(32,279)
Ending balance	1,565,983	1,406,083
APPROPRIATED RETAINED EARNINGS FOR CONSOLIDATED INVESTMENT VEHICLE		
Beginning balance	—	4,829
Net income reclassified to appropriated retained earnings	—	1,792
Ending balance	—	6,621
ACCUMULATED OTHER COMPREHENSIVE INCOME, NET		
Beginning balance	37,949	47,539
Net unrealized losses on investment securities	—	(137)
Reclassification for assets held for sale	(114)	—
Foreign currency translation adjustment	(21,524)	(15,092)
Ending balance	16,311	32,310

TOTAL STOCKHOLDERS' EQUITY	$4,583,789	$4,761,270

See Notes to Consolidated Financial Statements

LEGG MASON, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Six Months Ended September 30,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$78,633	$136,793
5.5% Senior Notes Due 2019:		
Loss on extinguishment	107,074	—
Allocation of repurchase payment	(98,418)	—
Adjustments to reconcile Net Income to net cash provided by operations:		
Depreciation and amortization	27,985	31,271
Accretion and amortization of securities discounts and premiums, net	545	1,520
Stock-based compensation	34,700	32,958
Net gains on investments	(2,149)	(7,790)
Net gains of consolidated investment vehicles	(2,124)	(4,128)
Deferred income taxes	4,639	38,385
Other	(1,252)	4,589
Decrease (increase) in assets:		
Investment advisory and related fees receivable	1,997	3,741
Net sales (purchases) of trading and other current investments	71,301	(38,590)
Other receivables	(5,720)	(7,554)
Other assets	14,524	(11,301)
Other assets of consolidated investment vehicles	87,989	36,942
Increase (decrease) in liabilities:		
Accrued compensation	(157,657)	(82,371)
Deferred compensation	2,172	(4,784)
Accounts payable and accrued expenses	(5,797)	(11,094)
Other liabilities	(19,489)	(8,074)
Other liabilities of consolidated investment vehicles	(7,332)	(10,296)
CASH PROVIDED BY OPERATING ACTIVITIES	131,621	100,217
CASH FLOWS FROM INVESTING ACTIVITIES		
Payments for fixed assets	(20,604)	(20,280)
Proceeds from sale of assets	—	1,351
Business acquisition, net of cash acquired	(10,558)	—
Change in restricted cash	2,988	(5,217)
Purchases of investment securities	(2,641)	(1,081)
Proceeds from sales and maturities of investment securities	2,688	1,361
Purchases of investments by consolidated investment vehicles	—	(14,440)
Proceeds from sales and maturities of investments by consolidated investment vehicles	—	95,141
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	$(28,127)	$56,835

LEGG MASON, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
(Dollars in thousands)
(Unaudited)

	Six Months Ended September 30, 2014	2013
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayment of long-term debt	$(645,561)	$(50,220)
Repayment of long-term debt of consolidated investment vehicles	(79,179)	(103,329)
Proceeds from issuance of long-term debt	658,769	—
Debt issuance costs	(4,529)	—
Issuance of common stock for stock-based compensation	15,883	13,002
Employee tax withholdings by settlement of net share transactions	(21,432)	(13,453)
Repurchase of common stock	(180,021)	(179,947)
Dividends paid	(34,759)	(30,430)
Net (redemptions/distributions paid to)/subscriptions received from noncontrolling interest holders	757	(3,164)
CASH USED IN FINANCING ACTIVITIES	(290,072)	(367,541)
EFFECT OF EXCHANGE RATES ON CASH	(12,470)	(10,691)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(199,048)	(221,180)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	858,022	933,036
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$658,974	$711,856

See Notes to Consolidated Financial Statements

LEGG MASON, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in thousands, except per share amounts or unless otherwise noted)
September 30, 2014
(Unaudited)

1. Interim Basis of Reporting

The accompanying unaudited interim consolidated financial statements of Legg Mason, Inc. and its subsidiaries (collectively “Legg Mason”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information and the applicable rules and regulations of the Securities and Exchange Commission (the "SEC"). The interim consolidated financial statements have been prepared using the interim basis of reporting and, as such, reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair statement of the results for the periods presented. The preparation of interim consolidated financial statements requires management to make assumptions and estimates that affect the amounts reported in the interim consolidated financial statements and accompanying notes. Actual amounts could differ from those estimates and the differences could have a material impact on the interim consolidated financial statements. Terms such as “we,” “us,” “our,” and “Company” refer to Legg Mason.

The nature of Legg Mason's business is such that the results of any interim period are not necessarily indicative of the results of a full year. Certain disclosures included in the Company's annual report are not required to be included on an interim basis in the Company's quarterly reports on Forms 10-Q. The Company has condensed or omitted these disclosures. Certain less significant amounts in prior period financial statements have been reclassified to conform to the current period presentation.

The information contained in the interim consolidated financial statements should be read in conjunction with Legg Mason's latest Annual Report on Form 10-K filed with the SEC.

2. Significant Accounting Policies

Consolidation

In the normal course of its business, Legg Mason sponsors and manages various types of investment vehicles. For its services, Legg Mason is entitled to receive management fees and may be eligible, under certain circumstances, to receive additional subordinated management fees or other incentive fees. Legg Mason's exposure to risk in these entities is generally limited to any equity investment it has made or is required to make, and any earned but uncollected management fees. Legg Mason did not sell or transfer assets to any of these investment vehicles. In accordance with financial accounting standards, Legg Mason consolidates certain sponsored investment vehicles, some of which are designated as consolidated investment vehicles (“CIVs”). The consolidation of investment vehicles has no impact on Net Income Attributable to Legg Mason, Inc. and does not have a material impact on Legg Mason's consolidated operating results. The change in the value of these CIVs, which is recorded in Other Non-Operating Income (Expense), is reflected in Net Income, net of amounts allocated to noncontrolling interests.

Certain investment vehicles Legg Mason sponsors and is the manager of are considered to be variable interest entities ("VIEs") (further described below) while others are considered to be voting rights entities (“VREs”) subject to traditional consolidation concepts based on ownership rights. Investment vehicles that are considered VREs are consolidated if Legg Mason has a controlling financial interest in the investment vehicle, absent substantive investor rights to replace the manager of the entity (kick-out rights). Legg Mason may also fund the initial cash investment in certain VRE investment vehicles to generate an investment performance track record in order to attract third-party investors in the product. Legg Mason's initial investment in a new product typically represents 100% of the ownership in that product. As further discussed below, these “seed capital investments” are consolidated as long as Legg Mason maintains a controlling financial interest in the product, but they are not designated as CIVs by Legg Mason unless the investment is longer term. Legg Mason held a longer-term controlling financial interest in one sponsored investment fund VRE, which has third-party investors and was consolidated and included as a CIV as of September 30, 2014, March 31, 2014, and September 30, 2013.

A VIE is an entity which does not have adequate equity to finance its activities without additional subordinated financial support; or the equity investors, as a group, do not have the normal characteristics of equity for a potential controlling financial interest.

Investment Company VIEs

For most sponsored investment fund VIEs deemed to be investment companies, including money market funds, Legg Mason determines it is the primary beneficiary of a VIE if it absorbs a majority of the VIE's expected losses, or receives a majority of the VIE's expected residual returns, if any. Legg Mason's determination of expected residual returns excludes gross fees paid to a decision maker if certain criteria are met. In determining whether it is the primary beneficiary of an investment company VIE, Legg Mason considers both qualitative and quantitative factors such as the voting rights of the equity holders; economic participation of all parties, including how fees are earned and paid to Legg Mason; related party (including employees') ownership; guarantees and implied relationships.

Legg Mason concluded it was the primary beneficiary of one sponsored investment fund VIE, which was consolidated (and designated a CIV) as of September 30, 2014, March 31, 2014 and September 30, 2013, despite significant third party investments in this product. As of September 30, 2014 and March 31, 2014, Legg Mason also concluded it was the primary beneficiary of 16 employee-owned funds it sponsors, which were consolidated and reported as CIVs.

Other VIEs

For other sponsored investment funds that do not meet the investment company criteria, Legg Mason determines it is the primary beneficiary of a VIE if it has both the power to direct the activities of a VIE that most significantly impact the entity's economic performance and the obligation to absorb losses, or the right to receive benefits, that potentially could be significant to a VIE.

As of September 30, 2014, Legg Mason had a variable interest in three collateralized loan obligations ("CLOs"). Legg Mason concluded it was not the primary beneficiary of these CLOs, which were not consolidated, as it holds no equity interest in these investment vehicles and their level of expected fees is insignificant. As of March 31, 2014 and September 30, 2013, Legg Mason had a variable interest in two of these CLOs, which also were not consolidated in either of these periods.

As of March 31, 2014 and September 30, 2013, Legg Mason concluded that it was the primary beneficiary of another CLO in which it held a variable interest. Although it held no equity interest in this investment vehicle, it had both the power to control and had a significant variable interest because of the level of its expected subordinated fees. As of March 31, 2014 and September 30, 2013, the balances related to this CLO were consolidated and reported as a CIV in the Company's consolidated financial statements. During the three months ended June 30, 2014, this CLO was substantially liquidated and therefore was not consolidated by Legg Mason as of September 30, 2014.

See Notes 4 and 12 for additional information regarding VIEs and VREs.

Noncontrolling Interests

For CIVs with third-party investors, the related noncontrolling interests are classified as redeemable noncontrolling interests if investors in these funds may request withdrawals at any time. Also included in redeemable noncontrolling interests are vested affiliate management equity plan interests. There were no nonredeemable noncontrolling interests as of September 30, 2014 or March 31, 2014. Net income attributable to noncontrolling interests in the Consolidated Statements of Income for the three and six months ended September 30, 2013 also includes Net income reclassified to appropriated retained earnings for consolidated investment vehicle in the Consolidated Balance Sheet as of September 30, 2013.

9

Net income attributable to noncontrolling interests for the three and six months ended September 30, included the following amounts:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Net income attributable to redeemable noncontrolling interests	$124	$17	$1,548	$898
Net income reclassified to appropriated retained earnings for consolidated investment vehicle	—	1,393	—	1,792
Total	$124	$1,410	$1,548	$2,690

Redeemable noncontrolling interests as of and for the six months ended September 30, included the following amounts:

	Six Months Ended September 30,	
	2014	2013
Balance, beginning of period	$45,144	$21,009
Net income attributable to redeemable noncontrolling interests	1,548	898
Net (redemptions/distributions paid to)/subscriptions received from noncontrolling interest holders	757	(3,164)
Balance, end of period	$47,449	$18,743

Accumulated Other Comprehensive Income
There were no significant amounts reclassified from Accumulated other comprehensive income to the Consolidated Statements of Income for the three or six months ended September 30, 2014 or 2013, except for $638 realized on the termination of a reverse treasury rate lock contract, as further described in Note 7.

Recent Accounting Developments
In May 2014, the Financial Accounting Standards Board (“FASB”) updated the guidance on revenue recognition. The updated guidance improves comparability and removes inconsistencies in revenue recognition practices across entities, industries, jurisdictions, and capital markets. This update will be effective for Legg Mason in fiscal 2018 and Legg Mason is evaluating the impact of its adoption.

In August 2014, the FASB updated the guidance on measuring the financial assets and financial liabilities of consolidated collateralized financing entities. The update requires that an entity electing to apply the guidance should measure both the financial assets and financial liabilities using the fair value of the consolidated collateralized financing entity’s financial assets or financial liabilities, whichever is more observable. This update also requires certain disclosures by entities that apply its provisions and will be effective for Legg Mason in fiscal 2017, unless adopted earlier. Legg Mason is evaluating the impact of its adoption.

3. Acquisitions and Disposition

QS Investors, LLC
Effective May 31, 2014, Legg Mason acquired all of the outstanding equity interests of QS Investors, LLC ("QS Investors"), a customized solutions and global quantitative equities provider, in accordance with a Purchase Agreement entered into in March 2014. At the time of acquisition, QS Investors had approximately $5,000,000 in assets under management ("AUM") and nearly $100,000,000 in assets under advisement.

The initial purchase price was a cash payment of $11,000, funded from existing cash. In addition, contingent consideration of up to $10,000 and $20,000 for the second and fourth anniversary payments may be due in July 2016 and July 2018, respectively, dependent on the achievement of certain net revenue targets, and subject to a potential catch-up adjustment in the fourth anniversary payment for any second anniversary payment shortfall. The contingent consideration liability established at closing had an acquisition date fair value of $13,370, which represented the present value of the contingent consideration expected to be paid. The contingent consideration liability is included in Other liabilities in the Consolidated Balance Sheet at September 30, 2014 and has accreted to $13,453.

A summary of the acquisition-date fair values of the assets acquired and liabilities assumed, after certain measurement period adjustments, are as follows:

Consideration	
Cash	$ 11,000
Contingent consideration	13,370
Total Consideration	24,370
Identifiable assets and liabilities	
Cash	441
Investments	3,281
Receivables	2,699
Amortizable asset management contracts	7,060
Fixed assets	599
Liabilities, net	(6,620)
Total identifiable assets and liabilities	7,460
Goodwill	$ 16,910

The fair value of the amortizable asset management contracts is being amortized over a period of 10 years. Purchase price allocated to goodwill is expected to be deductible for U.S. tax purposes over a period of 15 years.

Management estimated the fair values of the amortizable asset management contracts based upon discounted cash flow analyses, and the contingent consideration expected to be paid and discounted, based upon probability-weighted revenue projections, using unobservable market data inputs, which are Level 3 measurements. The significant assumptions used in these analyses at acquisition including projected annual cash flows, revenues and discount rates, are summarized as follows:

	Projected Cash Flow Attrition	Discount Rate
Amortizable asset management contracts	(10)%	15.0%

	Projected Revenue Growth Rates	Discount Rates
Contingent consideration	0% to 10% (weighted-average - 6%)	1.2% / 2.1%

Goodwill is principally attributable to synergies expected to arise with the integration of QS Investors.

The Company has not presented pro forma combined results of operations for this acquisition because the results of operations as reported in the accompanying Consolidated Statements of Income would not have been materially different. The financial results of QS Investors included in Legg Mason's consolidated financial results for the three and six months ended September 30, 2014 were not significant.

Over time, Legg Mason plans to integrate two existing affiliates, QS Batterymarch Financial Management, Inc. ("Batterymarch") and QS Legg Mason Global Asset Allocation, LLC ("LMGAA"), into QS Investors to capture synergies and leverage the best capabilities of each entity. In connection with the integration, Legg Mason expects to incur cumulative restructuring and transition costs up to approximately $40,000, primarily comprised of charges for employee termination benefits, including severance and retention incentives, as well as real estate related charges. Total charges for restructuring and transition costs of $24,140 have been recognized through September 30, 2014, which includes $7,946 and $21,582 for the three and six months, respectively, ended September 30, 2014, primarily recorded in Compensation and benefits in the Consolidated Statements of Income.

The table below presents a summary of changes in the restructuring and transition-related liability from March 31, 2013 through September 30, 2014 and cumulative charges incurred to date:

	Compensation	Other	Total
Balance as of December 31, 2013	$—	$—	$—
Accrued charges	2,161	111	2,272
Balance as of March 31, 2014	2,161	111	2,272
Accrued charges	18,828	596	19,424
Payments	(9,936)	(384)	(10,320)
Balance as of September 30, 2014	$11,053	$323	$11,376
Non-cash charges[1]			
Year ended March 31, 2014	$—	$286	$286
Six Months Ended September 30, 2014	588	1,570	2,158
Total	$588	$1,856	$2,444
Cumulative charges incurred as of September 30, 2014	$21,577	$2,563	$24,140

(1) Includes stock-based compensation expense and accelerated fixed asset depreciation.

Legg Mason expects to incur up to approximately $16,000 in additional restructuring and transition costs associated with the integration of Batterymarch and LMGAA into QS Investors, with up to approximately $13,000 of the anticipated remaining costs expected to be incurred in the remainder of fiscal 2015.

Fauchier Partners Management, Limited

On March 13, 2013, The Permal Group Ltd. ("Permal"), a wholly-owned subsidiary of Legg Mason, completed the acquisition of all of the outstanding share capital of Fauchier Partners Management, Limited ("Fauchier"), a European based manager of funds-of-hedge funds, from BNP Paribas Investment Partners, S.A. in accordance with a Sale and Purchase Agreement entered into in December 2012.

As of September 30, 2014, the fair value of the contingent consideration liability was $29,200, a decrease of $353 from March 31, 2014, all of which is attributable to changes in the exchange rate, net of accretion. The contingent consideration liability is included in Other current liabilities and Other non-current liabilities in the Consolidated Balance Sheets. Legg Mason has executed currency forwards to economically hedge the risk of movements in the exchange rate between the U.S. dollar and the British pound in which the estimated contingent liability payment amounts are denominated. See Note 11 for additional information regarding derivatives and hedging.

Legg Mason Investment Counsel & Trust

On June 4, 2014, Legg Mason announced an agreement to sell all of its equity interests in Legg Mason Investment Counsel & Trust Company N.A. (subsequently renamed 1919 Investment Counsel & Trust) ("LMIC") to Stifel Financial Corporation's Global Wealth Management segment. The sale is expected to be completed in November 2014.

Related assets and liabilities held for sale of $47,263 and $8,713, respectively, were included in Other current assets and Other current liabilities, respectively, in the Consolidated Balance Sheet at September 30, 2014. These assets included $11,994 of available-for-sale investments with related net unrealized gains of $114, previously included in Accumulated other comprehensive income, net, at March 31, 2014. The sale is not expected to have a material impact on Legg Mason's consolidated financial condition or results of operations.

12

4. Investments and Fair Value of Assets and Liabilities

The disclosures below include details of Legg Mason's assets and liabilities that are measured at fair value, excluding the assets and liabilities of CIVs. See Note 12, Variable Interest Entities and Consolidation of Investment Vehicles, for information related to the assets and liabilities of CIVs that are measured at fair value.

The fair values of financial assets and (liabilities) of the Company were determined using the following categories of inputs:

	As of September 30, 2014			
	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets:				
Cash equivalents[1]:				
Money market funds	$227,856	$—	$—	$227,856
Time deposits and other	—	58,561	—	58,561
Total cash equivalents	227,856	58,561	—	286,417
Current investments:				
Trading investments relating to long-term incentive compensation plans[2]	78,715	—	—	78,715
Trading investments of proprietary fund products and other trading investments[3]	233,544	85,264	170	318,978
Equity method investments relating to long-term incentive compensation plans, proprietary fund products and other investments[4][5]	8,544	8,686	—	17,230
Total current investments	320,803	93,950	170	414,923
Investments in partnerships, LLCs and other[6]	—	—	17,682	17,682
Equity method investments in partnerships and LLCs[4][6]	`—	—	55,857	55,857
Derivative assets[7]	5,243	—	—	5,243
Other investments[6]	—	—	85	85
Total	$553,902	$152,511	$73,794	$780,207
Liabilities:				
Long-term debt[8]	$—	$(249,451)	$—	$(249,451)
Contingent consideration liabilities[9]	—	—	(42,653)	(42,653)
Derivative liabilities[7]	(4,669)	(549)	—	(5,218)
Total	$(4,669)	$(250,000)	$(42,653)	$(297,322)

13

	As of March 31, 2014			
	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets:				
Cash equivalents[1]:				
Money market funds	$456,631	$—	$—	$456,631
Time deposits and other	—	106,226	—	106,226
Total cash equivalents	456,631	106,226	—	562,857
Current investments:				
Trading investments relating to long-term incentive compensation plans[2]	109,648	—	—	109,648
Trading investments of proprietary fund products and other trading investments[3]	260,251	75,015	190	335,456
Equity method investments relating to long-term incentive compensation plans, proprietary fund products and other investments[4][5]	8,497	14,125	—	22,622
Total current investments	378,396	89,140	190	467,726
Available-for-sale investment securities[6]	2,048	10,024	—	12,072
Investments in partnerships, LLCs and other[6]	—	2,878	21,586	24,464
Equity method investments in partnerships and LLCs[4][6]	—	—	62,973	62,973
Derivative assets[7]	3,584	—	—	3,584
Other investments[6]	—	—	90	90
Total	$840,659	$208,268	$84,839	$1,133,766
Liabilities:				
Contingent consideration liability[9]	$—	$—	$(29,553)	$(29,553)
Derivative liabilities[7]	(2,335)	—	—	(2,335)
Total	$(2,335)	$—	$(29,553)	$(31,888)

(1) Cash equivalents include highly liquid investments with original maturities of 90 days or less. Cash investments in actively traded money market funds are measured at net asset value ("NAV") and are classified as Level 1. Cash investments in time deposits and other are measured at amortized cost, which approximates fair value because of the short time between the purchase of the instrument and its expected realization, and are classified as Level 2.

(2) Primarily mutual funds where there is minimal market risk to the Company as any change in value is primarily offset by an adjustment to compensation expense and related deferred compensation liability.

(3) Trading investments of proprietary fund products and other trading investments consist of approximately 57% and 43% in equity and debt securities, respectively, as of September 30, 2014, and approximately 53% and 47% in equity and debt securities, respectively, as of March 31, 2014.

(4) Substantially all of Legg Mason's equity method investments are investment companies which record their underlying investments at fair value. Fair value is measured using Legg Mason's share of the investee's underlying net income or loss, which is predominately representative of fair value adjustments in the investments held by the equity method investee.

(5) Includes investments under the equity method (which approximate fair value) relating to long-term incentive compensation plans of $8,686 and $14,125 as of September 30, 2014 and March 31, 2014, respectively, and proprietary fund products and other investments of $8,544 and $8,497 as of September 30, 2014 and March 31, 2014, respectively, which are classified as Investment securities in the Consolidated Balance Sheets.

(6)

Amounts are included in Other non-current assets in the Consolidated Balance Sheets for each of the periods presented.

(7) See Note 11.

(8) See Note 7.

(9) See Note 3.

Proprietary fund products include seed capital investments made by Legg Mason to fund new investment strategies and products. Legg Mason had investments in proprietary fund products, which totaled $382,288 and $405,918, as of September 30, 2014 and March 31, 2014, respectively, which are substantially comprised of investments in 47 funds and 46 funds,

respectively, that are individually greater than $1,000, with minimal third party investment, and together comprise over 90% of the seed capital investments total in each period.
See Notes 2 and 12 for information regarding the determination of whether investments in proprietary fund products represent VIEs.
Substantially all of the above financial instruments where valuation methods rely on other than observable market inputs as a significant input utilize the equity method, the cost method, or NAV practical expedient discussed below, such that measurement uncertainty has little relevance.
The changes in financial assets and (liabilities) measured at fair value using significant unobservable inputs (Level 3) for the three and six months ended September 30, 2014 and 2013, are presented in the tables below:

	Value as of June 30, 2014	Purchases	Sales	Redemptions/ Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of September 30, 2014
Assets:							
Trading investments of proprietary fund products and other trading investments	$179	$—	$(9)	$—	$—	$ —	$170
Investments in partnerships, LLCs and other	21,654	—	(24)	(3,443)	—	(505)	17,682
Equity method investments in partnerships and LLCs	57,621	78	(990)	(363)	—	(489)	55,857
Other investments	92	—	—	—	—	(7)	85
	$79,546	$78	$(1,023)	$(3,806)	$—	$ (1,001)	$73,794
Liabilities:							
Contingent consideration liabilities	$(43,984)	$—	$—	$—	$—	$ 1,331	$(42,653)

15

	Value as of June 30, 2013	Purchases	Sales	Redemptions/Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of September 30, 2013
Assets:							
Trading investments of proprietary fund products and other trading investments	$233	$—	$—	$ (31)	$—	$ 7	$209
Investments in partnerships, LLCs and other	28,018	—	(424)	1	—	(406)	27,189
Equity method investments in partnerships and LLCs	63,353	2,570	(437)	(2,116)	—	269	63,639
Other investments	105	—	—	—	—	2	107
	$91,709	$2,570	$(861)	$ (2,146)	$—	$ (128)	$91,144
Liabilities:							
Contingent consideration liability	$(21,931)	$—	$—	$ —	$—	$ (1,404)	$(23,335)

	Value as of March 31, 2014	Purchases	Sales	Redemptions/ Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of September 30, 2014
Assets:							
Trading investments of proprietary fund products and other trading investments	$190	$—	$(19)	$—	$—	$(1)	$170
Investments in partnerships, LLCs and other	21,586	—	(24)	(3,443)	—	(437)	17,682
Equity method investments in partnerships and LLCs	62,973	1,046	(6,838)	(927)	—	(397)	55,857
Other investments	90	—	—	—	—	(5)	85
	$84,839	$1,046	$(6,881)	$(4,370)	$—	$(840)	$73,794
Liabilities:							
Contingent consideration liabilities	$(29,553)	$(13,370)	$—	$—	$—	$270	$(42,653)

	Value as of March 31, 2013	Purchases	Sales	Redemptions/Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of September 30, 2013
Assets:							
Trading investments of proprietary fund products and other trading investments	$246	$—	$—	$ (44)	$—	$7	$209
Investments in partnerships, LLCs and other	27,762	800	(617)	(164)	—	(592)	27,189
Equity method investments in partnerships and LLCs	66,338	2,766	(750)	(5,688)	—	973	63,639
Other investments	111	—	—	—	—	(4)	107
	$94,457	$3,566	$(1,367)	$ (5,896)	$—	$384	$91,144
Liabilities:							
Contingent consideration liability	$(21,900)	$—	$—	$ —	$—	$(1,435)	$(23,335)

Realized and unrealized gains and losses recorded for Level 3 investments are primarily included in Other Non-Operating Income (Expense) in the Consolidated Statements of Income. The change in unrealized gains (losses) for Level 3 investments and liabilities still held at the reporting date was $131 and $(2,397) for the three months ended September 30, 2014 and 2013, respectively. The change in unrealized losses for Level 3 investments and liabilities still held at the reporting date was $1,200 and $3,190 for the six months ended September 30, 2014 and 2013, respectively.

There were no transfers between Level 1 and Level 2 during the three or six months ended September 30, 2014 and 2013.

As a practical expedient, Legg Mason relies on the NAV of certain investments as their fair value. The NAVs that have been provided by the investees have been derived from the fair values of the underlying investments as of the respective reporting dates. The following table summarizes, as of September 30, 2014 and March 31, 2014, the nature of these investments and any related liquidation restrictions or other factors which may impact the ultimate value realized:

		Fair Value Determined Using NAV		As of September 30, 2014	
Category of Investment	Investment Strategy	September 30, 2014	March 31, 2014	Unfunded Commitments	Remaining Term
Funds-of-hedge funds	Global macro, fixed income, long/short equity, natural resources, systematic, emerging market, European hedge	$29,855 (1)	$34,771 (1)	n/a	n/a
Hedge funds	Fixed income - developed market, event driven, fixed income - hedge, relative value arbitrage, European hedge	17,379	19,461	$20,000	n/a
Private equity funds	Long/short equity	22,158 (2)	22,759 (2)	5,184	Up to 8 years
Other	Various	1,919	2,434	n/a	Various (3)
Total		$71,311 (4)	$79,425 (4)	$25,184	

n/a-not applicable

(1) Liquidation restrictions: 29% monthly redemption and 71% quarterly redemption as of September 30, 2014. 40% monthly redemption and 60% quarterly redemption as of March 31, 2014.

(2) Liquidations are expected over the remaining term.

(3) Of this balance, 12% has a remaining term of less than one year and 88% has a remaining term of 19 years.

(4) Comprised of 35% and 65% of Level 2 and Level 3 assets, respectively, as of September 30, 2014 and 31% and 69% of Level 2 and Level 3 assets, respectively, as of March 31, 2014.

There are no current plans to sell any of these investments held as of September 30, 2014.

5. Fixed Assets

Fixed assets consist of equipment, software and leasehold improvements. Equipment consists primarily of communications and technology hardware and furniture and fixtures. Software includes purchased software and internally developed software. Fixed assets are reported at cost, net of accumulated depreciation and amortization. The following table reflects the components of fixed assets as of:

	September 30, 2014	March 31, 2014

Equipment	$148,754	$147,663
Software	260,387	249,368
Leasehold improvements	208,812	209,747
Total cost	617,953	606,778
Less: accumulated depreciation and amortization	(435,862)	(417,537)
Fixed assets, net	$182,091	$189,241

Depreciation and amortization expense related to fixed assets was $13,551 and $12,176 for the three months ended September 30, 2014 and 2013, respectively, and $26,625 and $24,023 for the six months ended September 30, 2014 and 2013, respectively.

6. Intangible Assets and Goodwill

The following table reflects the components of intangible assets as of:

	September 30, 2014	March 31, 2014
Amortizable asset management contracts		
Cost	$176,707	$207,224
Accumulated amortization	(167,697)	(197,255)
Net	9,010	9,969
Indefinite–life intangible assets		
U.S. domestic mutual fund management contracts	2,106,351	2,106,351
Permal/Fauchier funds-of-hedge fund management contracts	698,104	698,104
Other fund management contracts	304,363	304,549
Trade names	52,800	52,800
	3,161,618	3,161,804
Intangible assets, net	$3,170,628	$3,171,773

In connection with the previously discussed agreement to sell LMIC, amortizable asset management contracts with a cost of $36,864 and accumulated amortization of $30,205 were reclassified to assets held for sale. Also, the May 31, 2014 acquisition of QS Investors included amortizable asset management contracts of $7,060. See Note 3 for additional information.

As of Legg Mason's most recent annual impairment test as of December 31, 2013, the assessed fair value of the indefinite-life domestic mutual funds contracts asset related to the Citigroup Asset Management ("CAM") acquisition exceeded the carrying value by approximately 21%; and the assessed fair value of the indefinite-life funds-of-hedge funds contracts asset related to the Permal and Fauchier acquisitions exceeded the combined carrying values by approximately 10%. Should market performance, flows, or related AUM levels decrease in the near term such that cash flow projections deviate from current projections, it is reasonably possible that the assets could be deemed to be impaired by a material amount.

As of September 30, 2014, amortizable asset management contracts are being amortized over a weighted-average remaining life of 8.4 years.

Estimated amortization expense for each of the next five fiscal years is as follows:

Remaining 2015	$553
2016	1,188
2017	1,188
2018	1,188
2019	1,188
Thereafter	3,705
Total	$9,010

The change in the carrying value of goodwill is summarized below:

	Gross Book Value	Accumulated Impairment	Net Book Value
Balance as of March 31, 2014	$2,402,423	$(1,161,900)	$1,240,523
Impact of excess tax basis amortization	(10,858)	—	(10,858)
Business acquisition, net of $8,104 reclassification relating to LMIC (See Note 3)	8,806	—	8,806
Other, including changes in foreign exchange rates	(7,136)	—	(7,136)
Balance as of September 30, 2014	$2,393,235	$(1,161,900)	$1,231,335

7. Long-Term Debt

The disclosures below include details of Legg Mason’s debt, excluding the debt of CIVs. See Note 12, Variable Interest Entities and Consolidation of Investment Vehicles, for information related to the debt of CIVs.

Long-term debt consists of the following:

	September 30, 2014				March 31, 2014
	Current Value	Fair Value Hedge Adjustment	Unamortized Discount (Premium)	Maturity Amount	Accreted Value
2.7% Senior Notes due 2019	$248,927	$549	$524	$250,000	$—
5.5% Senior Notes due 2019	—	—	—	—	645,042
3.95% Senior Notes due 2024	249,555	—	445	250,000	—
5.625% Senior Notes due 2044	553,580	—	(3,580)	550,000	393,784
Other term loans	219	—	—	219	438
Subtotal	1,052,281	549	(2,611)	1,050,219	1,039,264
Less: current portion	219	—	—	219	438
Total	$1,052,062	$549	$(2,611)	$1,050,000	$1,038,826

In June 2014, Legg Mason issued $250,000 of 2.7% Senior Notes due 2019 (the "2019 Notes"), $250,000 of 3.95% Senior Notes due 2024 (the "2024 Notes"), and an additional $150,000 of the existing 5.625% Senior Notes due 2044 (the "2044 Notes" and, together with the 2019 Notes and the 2024 Notes, the "Notes"). In July 2014, the Company used $658,769 in proceeds from the sale of the Notes, together with cash on hand, to call the outstanding $650,000 of 5.5% Senior Notes due 2019 (the "5.5% Senior Notes") and pay a related make-whole premium of $98,418 discussed below.

On June 23, 2014, Legg Mason entered into a reverse treasury rate lock contract with a financial intermediary, which was designated as a cash flow hedge. The contract was issued in connection with the retirement of the 5.5% Senior Notes. The Company entered into the reverse treasury rate lock agreement in order to hedge the variability in the retirement payment on the entire principal amount of debt. The reverse treasury rate lock contract effectively fixed the present value of the forecasted debt make-whole payment which was priced on July 18, 2014, to eliminate risk associated with changes in the five-year U.S. treasury yield.

The 5.5% Senior Notes were retired on July 23, 2014, and resulted in a pre-tax, non-operating charge of $107,074 , consisting of a make-whole premium of $98,418 to call the 5.5% Senior Notes, net of $638 from the settlement of the reverse treasury lock before related administrative fees, and $8,656 associated with existing deferred charges and original issue discount.

2.7% Senior Notes due 2019
The $250,000 2019 Notes were sold at a discount of $553, which is being amortized to interest expense over the five-year term. The 2019 Notes can be redeemed at any time prior to the scheduled maturity in part or in aggregate, at the greater of

the related principal amount at that time or the sum of the remaining scheduled payments discounted at the treasury rate (as defined) plus 0.20%, together with any related accrued and unpaid interest.

On June 23, 2014, Legg Mason entered into an interest rate swap contract with a financial intermediary with a notional amount of $250,000, which was designated as a fair value hedge. The interest rate swap is being used to effectively convert the 2019 Notes from fixed rate debt to floating rate debt and has identical terms as the underlying debt being hedged, so no ineffectiveness is expected. The swap has a five-year term, and matures on July 15, 2019. The fair value of the contract at September 30, 2014, was a derivative liability of $549, which is classified as Other liabilities with a corresponding fair value adjustment to the related carrying value of the debt in the Consolidated Balance Sheet. The swap payment dates coincide with the debt payment dates on July 15 and January 15. The related receipts/payments by Legg Mason are recorded as Interest expense in the Consolidated Statement of Income. Cash collateral of $2,000 was provided for the interest rate swap as of September 30, 2014. Since the terms and conditions of the hedged instruments are unchanged, the swap continues to be an effective fair value hedge.

3.95% Senior Notes due 2024
The $250,000 2024 Notes were sold at a discount of $458, which is being amortized to interest expense over the 10-year term. The 2024 Notes can be redeemed at any time prior to the scheduled maturity in part or in aggregate, at the greater of the related principal amount at that time or the sum of the remaining scheduled payments discounted at the treasury rate (as defined) plus 0.25%, together with any related accrued and unpaid interest.

5.625% Senior Notes due 2044
The $150,000 additional 2044 Notes were sold at a premium of $9,779, which is being amortized to interest expense over the 30-year term. The 2044 Notes can be redeemed at any time prior to the scheduled maturity in part or in aggregate, at the greater of the related principal amount at that time or the sum of the remaining scheduled payments discounted at the treasury rate (as defined) plus 0.30%, together with any related accrued and unpaid interest.

As of September 30, 2014, the aggregate maturities of long-term debt by fiscal year, based on their contractual terms, are as follows:

Remaining 2015	$219
2016	—
2017	—
2018	—
2019	—
Thereafter	1,050,000
Total	$1,050,219

At September 30, 2014, the estimated fair value of long-term debt was approximately $1,102,771, including $249,451 for the 2019 Notes which are carried at fair value in the Consolidated Balance Sheet. The debt fair value was estimated using publicly quoted market prices and was classified as Level 2 in the fair value hierarchy.

8. Stock-Based Compensation

Legg Mason's stock-based compensation includes stock options, an employee stock purchase plan, market-based performance shares payable in common stock, restricted stock awards and units, management equity plans and deferred compensation payable in stock. Shares available for issuance under the active equity incentive stock plan as of September 30, 2014, were 8,184. Options under Legg Mason’s employee stock plans have been granted at prices not less than 100% of the fair market value. Options are generally exercisable in equal increments over four or five years and expire within eight to ten years from the date of grant.

21

Stock Options

Compensation expense relating to stock options for the three months ended September 30, 2014, and 2013 was $2,953 and $3,746, respectively, and for the six months ended September 30, 2014, and 2013 was $6,217 and $6,987, respectively.

Stock option transactions under Legg Mason's equity incentive plans during the six months ended September 30, 2014, and 2013 are summarized below:

	Six Months Ended September 30,			
	2014		2013	
	Number of Shares	Weighted-Average Exercise Price Per Share	Number of Shares	Weighted-Average Exercise Price Per Share
Options Outstanding at March 31	4,801	$43.02	5,361	$53.13
Granted	916	47.64	1,215	33.64
Exercised	(453)	30.76	(405)	29.64
Canceled/forfeited	(522)	93.59	(881)	99.98
Options outstanding at September 30	4,742	$39.52	5,290	$42.65

At September 30, 2014, options were exercisable for 2,467 shares and the weighted-average exercise price was $41.32. Stock options exercisable at September 30, 2014, have a weighted-average remaining contractual life of 3.8 years. Unamortized compensation cost at September 30, 2014, was $21,166 and was related to unvested options for 2,275 shares. The unamortized compensation cost at September 30, 2014 is expected to be recognized over a weighted-average period of 1.8 years.

The weighted-average fair value of service-based stock option grants during the six months ended September 30, 2014 and 2013, excluding those granted to our Chief Executive Officer in May 2013 discussed below, using the Black-Scholes option pricing model, was $12.03 and $12.13 per share, respectively.

The following weighted-average assumptions were used in the model for grants in fiscal 2015 and 2014:

	Six Months Ended September 30,	
	2014	2013
Expected dividend yield	1.04 %	1.54 %
Risk-free interest rate	1.51 %	0.80 %
Expected volatility	29.53 %	45.08 %
Expected life (in years)	4.94	4.93

Legg Mason uses an equally weighted combination of both implied and historical volatility to measure expected volatility for calculating Black-Scholes option values.

In May 2013, Legg Mason awarded options to purchase 500 shares of Legg Mason, Inc. common stock at an exercise price of $31.46, equal to the then current market value of Legg Mason's common stock, to its Chief Executive Officer, which are included in the outstanding options table above. The award had a grant date fair value of $5,525 and is subject to vesting requirements, 25% of which vests over a two-year service period; 25% of which vests over a two-year service period and is subject to Legg Mason's common stock price equaling or exceeding $36.46 for 20 consecutive trading days; 25% of which is subject to Legg Mason's common stock price equaling or exceeding $41.46 for 20 consecutive trading days; and 25% of which is subject to Legg Mason's common stock price equaling or exceeding $46.46 for 20 consecutive trading days; as well as a requirement that certain shares received upon exercise are retained for a two-year period. In both January and June 2014, 25% of this award vested when the Legg Mason stock price met and exceeded $41.46 and $46.46, respectively, for 20 consecutive trading days.

The weighted-average fair value per share for these awards of $11.05 was estimated as of the grant date using a grant price of $31.46, and a Monte Carlo option pricing model with the following assumptions:

Expected dividend yield	1.48	%
Risk-free interest rate	0.86	%
Expected volatility	44.05	%

Restricted Stock

Compensation expense relating to restricted stock and restricted stock units for the three months ended September 30, 2014 and 2013, was $12,083 and $12,883, respectively, and for the six months ended September 30, 2014 and 2013, was $23,289 and $24,831, respectively.

Restricted stock and restricted stock unit transactions during the six months ended September 30, 2014 and 2013 are summarized below:

	Six Months Ended September 30,			
	2014		2013	
	Number of Shares	Weighted-Average Grant Date Value	Number of Shares	Weighted-Average Grant Date Value
Unvested Shares at March 31	3,334	$ 30.77	3,738	$ 27.99
Granted	1,159	47.77	1,289	35.16
Vested	(1,303)	30.90	(1,308)	28.91
Canceled/forfeited	(100)	36.14	(141)	28.91
Unvested Shares at September 30	3,090	$ 36.92	3,578	$ 30.20

Unamortized compensation cost related to unvested restricted stock and restricted stock unit awards at September 30, 2014 of $91,578 is expected to be recognized over a weighted-average period of 1.8 years.

Other

In May 2014, Legg Mason granted certain executive officers 78 performance share units as part of their fiscal 2014 incentive award with an aggregate value of $3,457. The performance share units which vest, and the number of shares payable at vesting, are determined based on Legg Mason’s relative total stockholder return over a three-year period ending April 30, 2017. Compensation expense relating to the performance units for the three and six months ended September 30, 2014 was $290 and $482, respectively.

The grant date fair value per unit for these awards of $44.11 was estimated as of the grant date using a Monte Carlo pricing model with the following assumptions:

Expected dividend yield	1.33	%
Risk-free interest rate	0.75	%
Expected volatility	30.81	%

Compensation expense relating to the stock purchase plan and deferred compensation payable in stock for the three months ended September 30, 2014 and 2013, was $141 and $87, respectively, and for the six months ended September 30, 2014 and 2013, was $558 and $232, respectively.

On June 28, 2013, Legg Mason implemented a management equity plan and granted units to key employees of Permal that entitle them to participate in 15% of the future growth of the Permal enterprise value (subject to appropriate discounts), if any, subsequent to the grant date. On March 31, 2014, a similar management equity plan was implemented by Legg Mason with a grant to certain key employees of ClearBridge Investments, LLC ("ClearBridge"). Independent valuations determined the aggregate cost of the awards to be approximately $9,000 and $16,000 for Permal and ClearBridge, respectively, which will be recognized as Compensation and benefits in the

Consolidated Statements of Income over the related vesting periods, through December 2017 and March 2019, respectively. Both arrangements provide that one-half of the respective cost will

23

be absorbed by the affiliate's incentive pool. Total compensation expense related to management equity plans was $1,301 and $2,603 for the three and six months ended September 30, 2014, respectively, and $908 for both the three and six months ended September 30, 2013.

During the six months ended September 30, 2014 and 2013, non-employee directors were granted 8 and 11 restricted stock units and 23 and 47 shares of common stock at a fair value of $1,550 and $1,950, respectively. As of September 30, 2014 and 2013, non-employee directors held 45 and 64 restricted stock units, respectively, which vest on the grant date and are, therefore, not included in the unvested shares of restricted stock and restricted stock units in the table above. As of September 30, 2013, non-employee directors held 44 stock options, which are included in the outstanding options table. During the six months ended September 30, 2014, there were 27 restricted stock units distributed. During the six months ended September 30, 2014 and 2013, non-employee directors did not exercise any stock options and there were 32 and 68 stock options canceled or forfeited, respectively, related to non-employee directors.

9. Commitments and Contingencies

Legg Mason leases office facilities and equipment under non-cancelable operating leases, and also has multi-year agreements for certain services. These leases and service agreements expire on varying dates through fiscal 2026. Certain leases provide for renewal options and contain escalation clauses providing for increased rentals based upon maintenance, utility and tax increases.

As of September 30, 2014, the minimum annual aggregate rentals under operating leases and service agreements are as follows:

Remaining 2015	$69,746
2016	123,328
2017	104,586
2018	90,734
2019	76,446
Thereafter	352,108
Total	$816,948

The minimum rental commitments shown above have not been reduced by $167,716 for minimum sublease rentals to be received in the future under non-cancelable subleases, of which approximately 40% is due from one counterparty. The lease reserve liability, which is included in the table below, for space subleased as of September 30, 2014 and March 31, 2014 was $40,629 and $36,170, respectively. If a sub-tenant defaults on a sublease, Legg Mason may incur operating charges to adjust the existing lease reserve liability to reflect expected future sublease rentals at reduced amounts, as a result of the then current commercial real estate market.

The above minimum rental commitments include $748,889 in real estate and equipment leases and $68,059 in service and maintenance agreements.

The minimum rental commitments shown above include $5,440 for commitments related to space that has been vacated, but for which subleases are being pursued. The related lease reserve liability, also included in the table below, was $4,242 and $19,330 as of September 30, 2014 and March 31, 2014, respectively, and remains subject to adjustment based on circumstances in the real estate markets that may require a change in assumptions or the actual terms of a sublease that is ultimately secured. The lease reserve liability takes into consideration various assumptions, including the expected amount of time it will take to secure a sublease agreement and prevailing rental rates in the applicable real estate markets.

24

The lease reserve liability for subleased space and vacated space for which subleases are being pursued is included in Other current liabilities and Other non-current liabilities in the Consolidated Balance Sheets. The table below presents a summary of the changes in the lease reserve liability:

Balance as of March 31, 2013	$66,912
Accrued charges for vacated and subleased space	7,371
Payments, net	(17,117)
Adjustments and other	(1,666)
Balance as of March 31, 2014	55,500
Payments, net	(6,927)
Adjustments and other	(3,702)
Balance as of September 30, 2014	$44,871

As of September 30, 2014, Legg Mason had commitments to invest approximately $33,480 in limited partnerships that make private investments. These commitments are expected to be outstanding, or funded as required, through the end of the respective investment periods ranging through fiscal 2021.

In connection with the acquisition of Fauchier in March 2013, as further discussed in Note 3, contingent consideration of up to approximately $24,000 and approximately $32,000 (using the foreign exchange rate as of September 30, 2014 for the £15,000 and £20,000 maximum contractual amounts, respectively), may be due on or about the second and fourth anniversaries of closing, respectively, which is dependent upon achieving certain levels of revenue, net of distribution costs, and subject to a potential catch-up adjustment in the fourth anniversary payment for any second anniversary payment shortfall. The fair value of the contingent consideration liability was $29,200 as of September 30, 2014, a decrease of $353 from March 31, 2014, all of which is attributable to changes in the exchange rate, net of accretion. Legg Mason has executed currency forwards to economically hedge the risk of movements in the exchange rate between the U.S. dollar and the British pound in which the estimated contingent liability payment amounts are denominated. See Note 11 for additional information regarding derivatives and hedging.

In connection with the acquisition of QS Investors in May 2014, as further discussed in Note 3, contingent consideration of up to approximately $10,000 and approximately $20,000 for the second and fourth anniversary payments may be due in July 2016 and July 2018, respectively, dependent on the achievement of certain net revenue targets, and subject to a potential catch-up adjustment in the fourth anniversary payment for any second anniversary payment shortfall. The contingent consideration liability established at closing, had an acquisition date fair value of $13,370, which represented the present value of the contingent consideration expected to be paid, and has accreted to $13,453 as of September 30, 2014.

On October 1, 2014, Legg Mason acquired all outstanding equity interests of Martin Currie (Holdings) Limited ("Martin Currie"), pursuant to a share purchase agreement dated July 24, 2014. Martin Currie is an international equity specialist based in the United Kingdom with $9,500,000 in AUM as of September 30, 2014 that expands Legg Mason's product offerings. The acquisition required an initial payment of approximately $202,000 (using the foreign exchange rate as of October 1, 2014 for the £125,000 per the contract). In addition, contingent consideration may be payable after March 31 following the first, second and third anniversaries of closing, aggregating up to approximately $527,000 (using the foreign exchange rate as of September 30, 2014 for the maximum £325,000 per the contract), inclusive of the payment of certain potential obligations, and dependent on the achievement by Martin Currie of certain financial thresholds. The acquired assets and liabilities and related results of operations of Martin Currie will be included in Legg Mason's financial statements, along with purchase accounting adjustments and related disclosures, subsequent to the acquisition date.

In the normal course of business, Legg Mason enters into contracts that contain a variety of representations and warranties and that provide general indemnifications, which are not considered financial guarantees by relevant accounting guidance. Legg Mason’s maximum exposure under these arrangements is unknown, as this would involve future claims that may be made against Legg Mason that have not yet occurred.

Legg Mason has been the subject of customer complaints and has also been named as a defendant in various legal actions arising primarily from securities brokerage, asset management and investment banking activities, including certain class actions, which primarily allege violations of securities laws and seek unspecified damages, which could be substantial. In the normal course of its business, Legg Mason has also received subpoenas and is currently involved in governmental and industry self-regulatory agency inquiries, investigations and, from time to time, proceedings involving asset management activities. In accordance with guidance for accounting for contingencies, Legg Mason has established provisions for estimated losses from pending complaints, legal actions, investigations and proceedings when it is probable that a loss has been incurred and a reasonable estimate of loss can be made.

In a transaction with Citigroup in December 2005, Legg Mason transferred to Citigroup the subsidiaries that constituted its Private Client/Capital Markets ("PC/CM") businesses, thus transferring the entities that would have primary liability for most of the customer complaint, litigation and regulatory liabilities and proceedings arising from those businesses. However, as part of that transaction, Legg Mason agreed to indemnify Citigroup for most customer complaint, litigation and regulatory liabilities of Legg Mason's former PC/CM businesses that result from pre-closing events. While the ultimate resolution of these matters cannot be determined based on current information, after consultation with legal counsel, management believes that any accrual or range of reasonably possible losses as of September 30, 2014 is not material. Similarly, although Citigroup transferred to Legg Mason the entities that would be primarily liable for most customer complaint, litigation and regulatory liabilities and proceedings of the CAM business, Citigroup has agreed to indemnify Legg Mason for most customer complaint, litigation and regulatory liabilities of the CAM business that result from pre-closing events.

Legg Mason cannot estimate the reasonably possible loss or range of loss associated with matters of litigation and other proceedings, including those described above as customer complaints, legal actions, inquiries, proceedings and investigations. The inability to provide a reasonably possible amount or range of losses is not because there is uncertainty as to the ultimate outcome of a matter, but because liability and damage issues have not developed to the point where Legg Mason can conclude that there is both a reasonable possibility of a loss and a meaningful amount or range of possible losses. There are numerous aspects to customer complaints, legal actions, inquiries, proceedings and investigations that prevent Legg Mason from estimating a related amount or range of reasonably possible losses. These aspects include, among other things, the nature of the matters; that significant relevant facts are not known, are uncertain or are in dispute; and that damages sought are not specified, are uncertain, unsupportable or unexplained. In addition, for legal actions, discovery may not yet have started, may not be complete or may not be conclusive, and meaningful settlement discussions may not have occurred. Further, for regulatory matters, investigations may run their course without any clear indication of wrongdoing or fault until their conclusion.

In management's opinion, an adequate accrual has been made as of September 30, 2014, to provide for any probable losses that may arise from matters for which the Company could reasonably estimate an amount. Legg Mason's financial condition, results of operations and cash flows could be materially affected during a period in which a matter is ultimately resolved. In addition, the ultimate costs of litigation-related charges can vary significantly from period-to-period, depending on factors such as market conditions, the size and volume of customer complaints and claims, including class action suits, and recoveries from indemnification, contribution, insurance reimbursement, or reductions in compensation under revenue share arrangements.

10. Earnings Per Share

Basic earnings per share ("EPS") is calculated by dividing Net Income Attributable to Legg Mason, Inc. by the weighted-average number of shares outstanding. The calculation of weighted-average shares includes common shares and unvested restricted shares deemed to be participating securities. Diluted EPS is similar to basic EPS, but adjusts for the effect of potentially issuable common shares, except when inclusion is antidilutive.

During the three and six months ended September 30, 2014, Legg Mason repurchased and retired 1,840 and 3,711 shares of its common stock, respectively, for $90,022 and $180,021, respectively, through open market purchases. These repurchases reduced weighted-average shares outstanding by 985 and 1,858 shares for the three and six months ended September 30, 2014, respectively. During the three and six months ended September 30, 2013, Legg Mason repurchased and retired 2,693 and 5,317 shares of its common stock, respectively, for $89,996 and $179,996, respectively, through open market purchases. These repurchases reduced weighted-average shares outstanding by 3,912 and 2,447 shares for the three and six months ended September 30, 2013, respectively.

The following table presents the computations of basic and diluted EPS:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Weighted-average basic shares outstanding	115,799	122,974	116,459	124,095
Potential common shares:				
Employee stock options	1,141	233	1,115	213
Weighted-average diluted shares	116,940	123,207	117,574	124,308
Net Income	$5,021	$87,698	$78,633	$136,793
Less: Net income attributable to noncontrolling interests	124	1,410	1,548	2,690
Net Income Attributable to Legg Mason, Inc.	$4,897	$86,288	$77,085	$134,103
Net Income per share Attributable to Legg Mason, Inc. common shareholders				
Basic	$0.04	$0.70	$0.66	$1.08
Diluted	$0.04	$0.70	$0.66	$1.08

The diluted EPS calculations for the three and six months ended September 30, 2014 and 2013, exclude any potential common shares issuable under the 14,205 warrants issued in connection with the repurchase of the 2.5% Convertible Senior Notes in May 2012 because the market price of Legg Mason common stock did not exceed the exercise price, and therefore, the warrants would be antidilutive.
Options to purchase 1,404 and 3,846 shares for the three months ended September 30, 2014 and 2013, respectively, and 1,366 and 4,423 shares for the six months ended September 30, 2014 and 2013, respectively, were not included in the computation of diluted EPS because the presumed proceeds from exercising such options, including the related income tax benefits, exceed the average price of the common shares for the period and therefore, the options are deemed antidilutive. Further, market- and performance-based awards are excluded from potential dilution until the designated market or performance condition is met.

11. Derivatives and Hedging

The disclosures below detail Legg Mason's derivatives and hedging activities excluding the derivatives and hedging activities of CIVs. See Note 12, Variable Interest Entities and Consolidation of Investment Vehicles, for information related to the derivatives and hedging of CIVs.

Legg Mason uses currency forwards to economically hedge the risk of movements in exchange rates, primarily between the U.S. dollar, British pound, Japanese yen, Australian dollar, euro, Singapore dollar, Chinese yuan, Indian rupee, Indonesian rupiah, Malaysian ringgit, Philippine peso, Thai baht, Chilean peso, Swiss franc and South Korean won. In the Consolidated Balance Sheets, Legg Mason nets the fair value of certain foreign currency forwards or futures contracts executed with the same counterparty where Legg Mason has both the legal right and intent to settle the contracts on a net basis, resulting in net Other assets of $574 and $1,249 as of September 30, 2014 and March 31, 2014, respectively.

Legg Mason also uses market hedges on certain seed capital investments by entering into futures contracts to sell index funds that benchmark the hedged seed capital investments. Open futures contracts required cash collateral of $6,547 and $12,985 as of September 30, 2014 and March 31, 2014, respectively.

With the exception of the reverse treasury rate lock contract and interest rate swap contract discussed in Note 7, Legg Mason has not designated any derivatives as hedging instruments for accounting purposes during the periods ended September 30, 2014, March 31, 2014 and September 30, 2013.

27

The following table presents the fair values as of September 30, 2014 and March 31, 2014, of derivative instruments, classified as Other assets and Other liabilities:

	September 30, 2014		March 31, 2014	
	Assets	Liabilities	Assets	Liabilities
Derivative instruments designated as hedging instruments (See Note 7)				
Interest rate swap	$—	$549	$—	$—
Total derivative instruments designated as hedging instruments	—	549	—	—
Derivative instruments not designated as hedging instruments				
Currency forward contracts	1,483	4,652	3,271	825
Futures and forward contracts	3,760	17	313	1,510
Total derivative instruments not designated as hedging instruments	5,243	4,669	3,584	2,335
Total derivative instruments	$5,243	$5,218	$3,584	$2,335

The following tables present gains (losses) recognized in the Consolidated Statements of Income on derivative instruments. As described above, the currency, futures and forward contracts included below are economic hedges of interest rate and market risk of certain operating and investing activities of Legg Mason, including foreign exchange risk on acquisition contingent consideration. Gains and losses on these derivative instruments substantially offset gains and losses of the economically hedged items.

		Three Months Ended September 30,			
		2014		2013	
	Income Statement Classification	Gains	Losses	Gains	Losses
Derivatives not designated as hedging instruments					
Currency forward contracts for:					
Operating activities	Other expense	$1,568	$(6,938)	$4,497	$(658)
Seed capital investments	Other non-operating income (expense)	881	(23)	346	(1,326)
Futures and forward contracts for seed capital investments	Other non-operating income (expense)	5,540	(2,266)	747	(8,359)
Total gain (loss) from derivatives not designated as hedging instruments		7,989	(9,227)	5,590	(10,343)
Derivative designated as a fair value hedge (See Note 7)					
Interest rate swap	Interest expense	—	(1,296)	—	—
Reverse treasury rate lock	Other non-operating income (expense)	638	—	—	—
Total		$8,627	$(10,523)	$5,590	$(10,343)

		Six Months Ended September 30,			
		2014		2013	
	Income Statement Classification	Gains	Losses	Gains	Losses
Derivatives not designated as hedging instruments					
Currency forward contracts for:					
Operating activities	Other expense	$2,219	$(5,165)	$4,322	$(2,112)
Seed capital investments	Other non-operating income (expense)	749	(211)	778	(1,470)