LEGG MASON, INC.
Form 10-Q
November 06, 2012

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, 2012
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.

131,713,033 shares of common stock as of the close of business on November 1, 2012.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

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

	September 30, 2012	March 31, 2012
ASSETS		
Current Assets		
Cash and cash equivalents	$897,968	$1,382,263
Cash and cash equivalents of consolidated investment vehicles	28,704	26,139
Restricted cash	2,564	2,167
Receivables:		
Investment advisory and related fees	325,228	333,777
Other	35,835	100,060
Investment securities	354,355	412,119
Investment securities of consolidated investment vehicles	29,512	31,575
Deferred income taxes	111,163	117,391
Other	45,931	51,977
Total current assets	1,831,260	2,457,468
Fixed assets, net	229,982	239,411
Intangible assets, net	3,849,916	3,856,866
Goodwill	1,256,146	1,275,045
Investments of consolidated investment vehicles	288,132	294,853
Deferred income taxes	168,319	142,706
Other	249,396	287,653
Other assets of consolidated investment vehicles	1,748	1,745
Total Assets	$7,874,899	$8,555,747
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Current Liabilities		
Accrued compensation	$282,923	$409,759
Accounts payable and accrued expenses	193,416	195,808
Short-term borrowings	—	250,000
Current portion of long-term debt	58,372	1,278
Other	63,919	114,840
Other current liabilities of consolidated investment vehicles	684	4,097
Total current liabilities	599,314	975,782
Deferred compensation	44,756	57,339
Deferred income taxes	211,395	242,567
Other	166,095	167,544
Other liabilities of consolidated investment vehicles	3,514	3,872
Long-term debt	1,094,467	1,135,614
Long-term debt of consolidated investment vehicles	277,309	271,707
Total Liabilities	2,396,850	2,854,425

Commitments and Contingencies (Note 8)		
Redeemable Noncontrolling Interests	21,549	24,031
Stockholders’ Equity		
Common stock, par value $.10; authorized 500,000,000 shares; issued 131,707,918 shares and 139,874,034 shares, respectively	13,171	13,987
Additional paid-in capital	3,610,904	3,864,216
Employee stock trust	(33,245)	(32,419)
Deferred compensation employee stock trust	33,245	32,419
Retained earnings	1,757,184	1,715,395
Appropriated retained earnings for consolidated investment vehicle	9,175	12,221
Accumulated other comprehensive income, net	66,066	71,472
Total Stockholders’ Equity	5,456,500	5,677,291
Total Liabilities and Stockholders’ Equity	$7,874,899	$8,555,747

See Notes to Consolidated Financial Statements

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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,	
	2012	2011	2012	2011
Operating Revenues				
Investment advisory fees:				
Separate accounts	$183,426	$196,019	$365,862	$400,812
Funds	362,907	376,835	719,381	776,979
Performance fees	10,279	9,984	18,845	28,598
Distribution and service fees	81,915	85,774	163,538	177,838
Other	1,768	1,285	3,361	2,778
Total operating revenues	640,295	669,897	1,270,987	1,387,005
Operating Expenses				
Compensation and benefits	302,492	257,651	572,754	558,003
Transition-related compensation	—	12,346	—	23,741
Total compensation and benefits	302,492	269,997	572,754	581,744
Distribution and servicing	145,135	160,391	314,960	341,147
Communications and technology	35,831	41,571	73,461	82,072
Occupancy	27,318	35,700	57,570	68,938
Amortization of intangible assets	3,504	5,504	7,009	11,082
Other	46,281	49,882	89,422	94,804
Total operating expenses	560,561	563,045	1,115,176	1,179,787
Operating Income	79,734	106,852	155,811	207,218
Other Non-Operating Income (Expense)				
Interest income	1,718	2,982	3,654	6,037
Interest expense	(14,118)	(21,636)	(33,345)	(43,997)
Other income (expense), net, including $68,975 debt extinguishment loss in May 2012	28,655	(35,502)	(43,978)	(32,099)
Other non-operating income (loss) of consolidated investment vehicles, net	1,503	3,081	(2,631)	8,183
Total other non-operating income (expense)	17,758	(51,075)	(76,300)	(61,876)
Income Before Income Tax Provision	97,492	55,777	79,511	145,342
Income tax provision (benefit)	16,397	(1,606)	11,400	26,261
Net Income	81,095	57,383	68,111	119,081
Less: Net income (loss) attributable to noncontrolling interests	298	719	(3,228)	2,465
Net Income Attributable to Legg Mason, Inc.	$80,797	$56,664	$71,339	$116,616
Net Income per Share Attributable to Legg Mason, Inc. Common Shareholders:				
Basic	$0.60	$0.39	$0.52	$0.80
Diluted	$0.60	$0.39	$0.52	$0.80

Weighted Average Number of Shares Outstanding				
Basic	134,098	143,877	136,396	146,529
Diluted	134,128	143,931	136,425	146,625
Dividends Declared per Share	$0.11	$0.08	$0.22	$0.16

See Notes to Consolidated Financial Statements

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2012	2011	2012	2011
Net Income	$81,095	$57,383	$68,111	$119,081
Other comprehensive income:				
Foreign currency translation adjustment	7,666	(46,026)	(5,469)	(32,666)
Unrealized gains on investment securities:				
Unrealized holding gains, net of tax provision of $2, $124, $43 and $172, respectively	3	186	65	253
Reclassification adjustment for (gains) losses included in net income	7	—	(2)	4
Net unrealized gains on investment securities	10	186	63	257
Total other comprehensive income (loss)	7,676	(45,840)	(5,406)	(32,409)
Comprehensive Income	88,771	11,543	62,705	86,672
Less: Comprehensive income (loss) attributable to noncontrolling interests	298	719	(3,228)	2,465
Comprehensive Income Attributable to Legg Mason, Inc.	$88,473	$10,824	$65,933	$84,207

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,	
	2012	2011
COMMON STOCK		
Beginning balance	$13,987	$15,022
Stock options and other stock-based compensation	6	7
Deferred compensation employee stock trust	5	4
Deferred compensation, net	175	120
Equity Units exchanged	—	183
Employee tax withholdings by net share transactions	(29)	—
Shares repurchased and retired	(973)	(1,360)
Ending balance	13,171	13,976
ADDITIONAL PAID-IN CAPITAL		
Beginning balance	3,864,216	4,111,095
Stock options and other stock-based compensation	7,173	9,800
Deferred compensation employee stock trust	1,232	1,477
Deferred compensation, net	20,846	16,487
Equity Units exchanged	—	102,831
Employee tax withholdings by net share transactions	(7,632)	—
Shares repurchased and retired	(244,098)	(398,906)
Allocation from 2.5% Convertible Senior Notes repurchase, net of tax	(30,833)	—
Ending balance	3,610,904	3,842,784
EMPLOYEE STOCK TRUST		
Beginning balance	(32,419)	(34,466)
Shares issued to plans	(1,237)	(1,481)
Distributions and forfeitures	411	914
Ending balance	(33,245)	(35,033)
DEFERRED COMPENSATION EMPLOYEE STOCK TRUST		
Beginning balance	32,419	34,466
Shares issued to plans	1,237	1,481
Distributions and forfeitures	(411)	(914)
Ending balance	33,245	35,033
RETAINED EARNINGS		
Beginning balance	1,715,395	1,539,984
Net income attributable to Legg Mason, Inc.	71,339	116,616
Dividends declared	(29,550)	(23,695)
Ending balance	1,757,184	1,632,905
APPROPRIATED RETAINED EARNINGS FOR CONSOLIDATED INVESTMENT VEHICLE		
Beginning balance	12,221	10,922
Net loss reclassified to appropriated retained earnings	(3,046)	(5,802)
Ending balance	9,175	5,120
ACCUMULATED OTHER COMPREHENSIVE INCOME, NET		
Beginning balance	71,472	93,361

Net unrealized holding gains on investment securities	63	257
Foreign currency translation adjustment	(5,469)	(32,666)
Ending balance	66,066	60,952
TOTAL STOCKHOLDERS' EQUITY	$5,456,500	$5,555,737

See Notes to Consolidated Financial Statements

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

	Six Months Ended September 30,	
	2012	2011
Cash Flows from Operating Activities		
Net Income	$68,111	$119,081
2.5% Convertible Senior Notes:		
Allocation of repurchase payment	(216,038)	—
Loss on extinguishment	68,975	—
Adjustments to reconcile Net Income to net cash provided by operations:		
Depreciation and amortization	33,480	45,045
Imputed interest for 2.5% Convertible Senior Notes	5,839	19,230
Accretion and amortization of securities discounts and premiums, net	1,790	2,381
Stock-based compensation	27,160	25,948
Net (gains) losses on investments	(23,072)	37,846
Net losses of consolidated investment vehicles	4,063	2,198
Deferred income taxes	(6,278)	17,701
Other	2,387	901
Decrease (increase) in assets:		
Investment advisory and related fees receivable	9,458	40,218
Net sales (purchases) of trading and other current investments	119,265	(44,822)
Other receivables	7,927	(3,605)
Other assets	6,030	14,419
Other assets of consolidated investment vehicles	666	22,479
Increase (decrease) in liabilities:		
Accrued compensation	(126,576)	(73,968)
Deferred compensation	(12,583)	(32,134)
Accounts payable and accrued expenses	(2,348)	(18,370)
Other liabilities	(1,469)	9,186
Other liabilities of consolidated investment vehicles	(3,666)	(15,565)
Cash Provided by (Used in) Operating Activities	(36,879)	168,169
Cash Flows from Investing Activities		
Payments for fixed assets	(18,316)	(14,577)
Change in restricted cash	(757)	7,705
Purchases of investment securities	(4,406)	(3,754)
Proceeds from sales and maturities of investment securities	4,000	3,590
Purchases of investments by consolidated investment vehicles	(74,172)	(113,668)
Proceeds from sales and maturities of investments by consolidated investment vehicles	81,508	123,765
Cash Provided by (Used in) Investing Activities	$(12,143)	$3,061

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

	Six Months Ended September 30,	
	2012	2011
Cash Flows from Financing Activities		
Repayment of short-term borrowings	$(250,000)	$—
Repayment of 2.5% Convertible Senior Notes, net of operating allocation	(1,040,212)	—
Repayment of long-term debt	(634)	(391)
Proceeds from issuance of long-term debt	1,143,246	—
Debt issuance costs	(8,642)	—
Issuance of common stock	1,014	1,453
Repurchase of common stock	(252,732)	(400,266)
Dividends paid	(26,251)	(21,029)
Net repayments of consolidated investment vehicles	—	(18,309)
Net (redemptions/distributions paid to)/subscriptions received from noncontrolling interest holders	(2,300)	649
Cash Used in Financing Activities	(436,511)	(437,893)
Effect of Exchange Rate Changes on Cash	1,238	(15,611)
Net Decrease in Cash and Cash Equivalents	(484,295)	(282,274)
Cash and Cash Equivalents at Beginning of Period	1,382,263	1,375,918
Cash and Cash Equivalents at End of Period	$897,968	$1,093,644

See Notes to Consolidated Financial Statements

LEGG MASON, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share amounts or unless otherwise noted)
September 30, 2012
(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.

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. The fiscal year-end condensed balance sheet was derived from audited financial statements and, in accordance with interim financial information standards, does not include all disclosures required by U.S. GAAP for annual financial statements. Certain 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.

Terms such as “we,” “us,” “our,” and “Company” refer to Legg Mason.

2. Significant Accounting Policies

Consolidation
In accordance with financial accounting standards on consolidation, Legg Mason consolidates and separately identifies certain sponsored investment vehicles, the most significant of which is a collateralized loan obligation entity (“CLO”). The consolidation of these 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 consolidated investment vehicles, which is recorded in Other non-operating income (expense), is reflected in its Net Income, net of amounts allocated to noncontrolling interests. Also, see Note 12 for additional information regarding the consolidation of investment vehicles.

Restructuring Costs
In May 2010, Legg Mason's management committed to a plan to streamline its business model as further described in Note 11. The streamlining initiative was completed as of March 31, 2012. The costs associated with this initiative primarily related to employee termination benefits, incentives to retain employees during the transition period, charges for consolidating leased office space, and contract termination costs. Termination benefits, including severance and retention incentives, were recorded as Transition-related compensation in the Consolidated Statements of Income. These compensation items required employees to provide future service and were therefore expensed ratably over the

required service period. Contract termination and other costs were expensed when incurred.

New Capital Plan

In May 2012, Legg Mason implemented a new capital plan for the refinancing/restructuring of debt, the completion of the existing share repurchase authorization, and the authorization of further share repurchases. As a result, Net Income Attributable to Legg Mason, Inc. for the six months ended September 30, 2012, includes a pre-tax loss on debt extinguishment of $68,975 and a net reduction in outstanding debt obligations of $350,000. See Notes 6 and 9 for further details.

Income Taxes

In July 2011, The U.K. Finance Act 2011 was enacted, which reduced the main U.K. corporate tax rate from 27% to 26% effective April 1, 2011, and from 26% to 25% effective April 1, 2012. In July 2012, The U.K. Finance Act 2012 was enacted, further reducing the main U.K. corporate tax rate to 24% effective April 1, 2012 and 23% effective April 1, 2013. The reductions in the U.K. corporate tax rate resulted in tax benefits of $18,075 and $18,268, recognized in the quarters ended September 30, 2012 and 2011, respectively, as a result of the revaluation of existing deferred tax assets and liabilities at the new rates. As a result of the revaluation adjustments, the effective tax rate for the three and six months ended September 30, 2012, was reduced by 18.5 percentage points and 22.7 percentage points, respectively. Similarly, the effective tax rate for the three and six months ended September 30, 2011, was reduced by 32.8 percentage points and 12.6 percentage points, respectively.

Noncontrolling Interests

Noncontrolling interests related to consolidated investment vehicles ("CIVs") are classified as redeemable noncontrolling interests if investors in these funds may request withdrawals at any time. There are no nonredeemable noncontrolling interests as of September 30, 2012, March 31, 2012, or September 30, 2011. As noted above, Net income (loss) attributable to noncontrolling interests in the Consolidated Statements of Income also includes Net income (loss) reclassified to Appropriated retained earnings for consolidated investment vehicle in the Consolidated Balance Sheets.

Net income (loss) attributable to noncontrolling interests for the three and six months ended September 30, 2012 and 2011, included the following amounts:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2012	2011	2012	2011
Net income (loss) attributable to redeemable noncontrolling interests	$479	$4,376	$(182)	$8,267
Net loss reclassified to Appropriated retained earnings for consolidated investment vehicle	(181)	(3,657)	(3,046)	(5,802)
Total	$298	$719	$(3,228)	$2,465

Redeemable noncontrolling interests as of and for the six months ended September 30, 2012 and 2011, were as follows:

	Six Months Ended September 30,	
	2012	2011
Balance, beginning of period	$24,031	$36,712
Net income (loss) attributable to redeemable noncontrolling interests	(182)	8,267
Net (redemptions/distributions paid to)/subscriptions received from noncontrolling interest holders	(2,300)	649
Balance, end of period	$21,549	$45,628

Recent Accounting Developments

In July 2012, the FASB updated the guidance on the annual indefinite-lived intangible asset tests for impairment. The update permits companies to assess qualitative factors to determine if it is more likely than not that the fair value of the intangible asset is less than its carrying amount as a basis for determining whether it is necessary to perform the currently required quantitative fair value assessment. This update will be effective for Legg Mason in fiscal 2014, if not adopted early. This update is not expected to have a material effect on Legg Mason's recorded indefinite-lived assets, and Legg Mason is still evaluating its adoption.

3. Fair Values 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, 2012			
	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	$535,977	$—	$—	$535,977
Time deposits	—	102,481	—	102,481
Total cash equivalents	535,977	102,481	—	638,458
Investment securities:				
Trading investments relating to long-term incentive compensation plans[2]	92,999	—	—	92,999
Trading proprietary fund products and other investments[3]	119,940	79,304	—	199,244
Equity method investments relating to long-term incentive compensation plans, proprietary fund products and other investments[4][5]	12,402	38,005	11,705	62,112
Total current investments	225,341	117,309	11,705	354,355
Available-for-sale investment securities[6]	2,102	10,290	12	12,404
Investments in partnerships, LLCs and other[6]	1,008	2,517	28,041	31,566
Equity method investments in partnerships and LLCs[4][6]	1,375	4	129,294	130,673
Derivative assets:				
Currency and market hedges	939	—	—	939
Other investments[6]	—	—	119	119
	$766,742	$232,601	$169,171	$1,168,514
Liabilities:				
Derivative liabilities:				
Currency and market hedges	$(907)	$—	$—	$(907)

	As of March 31, 2012			
	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	$893,738	$—	$—	$893,738
Time deposits	—	88,289	—	88,289
Total cash equivalents	893,738	88,289	—	982,027
Investment securities:				
Trading investments relating to long-term incentive compensation plans[(2)]	111,257	—	—	111,257
Trading proprietary fund products and other investments[(3)]	143,002	79,583	—	222,585
Equity method investments relating to long-term incentive compensation plans, proprietary fund products and other investments[(4)(5)]	11,565	54,934	11,778	78,277
Total current investments	265,824	134,517	11,778	412,119
Available-for-sale investment securities[(6)]	2,091	9,810	12	11,913
Investments in partnerships, LLCs and other[(6)]	851	5,351	28,763	34,965
Equity method investments in partnerships and LLCs[(4)(6)]	1,415	1,348	166,438	169,201
Derivative assets:				
Currency and market hedges	84	—	—	84
Other investments[(6)]	—	—	112	112
	$1,164,003	$239,315	$207,103	$1,610,421
Liabilities:				
Derivative liabilities:				
Currency and market hedges	$(886)	$—	$—	$(886)

(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 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 proprietary fund products and other investments primarily represent mutual funds that are invested approximately 52% and 48% in equity and debt securities, respectively, as of both September 30, 2012 and March 31, 2012.

(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 approximates fair value) relating to long-term incentive compensation plans of $38,005 and $54,934 as of September 30, 2012 and March 31, 2012, respectively, and proprietary fund products and other investments of $24,107 and $23,343 as of September 30, 2012 and March 31, 2012, respectively, which are classified as Investment securities on the Consolidated Balance Sheets.

(6)

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

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, such that measurement uncertainty has little relevance.

The changes in financial assets measured at fair value using significant unobservable inputs (Level 3) for the three and six months ended September 30, 2012 and 2011, are presented in the tables below:

	Value as of June 30, 2012	Purchases	Sales	Redemptions/Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of September 30, 2012
Assets:							
Equity method investments in proprietary fund products	$11,296	$—	$—	$ —	$—	$ 409	$11,705
Investments in partnerships, LLCs and other	28,513	—	(788)	(415)	—	731	28,041
Equity method investments in partnerships and LLCs	160,602	122	(204)	(45,488)	—	14,262	129,294
Other investments	128	—	—	—	—	3	131
	$200,539	$122	$(992)	$ (45,903)	$—	$ 15,405	$169,171

	Value as of June 30, 2011	Purchases	Sales	Redemptions/Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of September 30, 2011
Assets:							
Trading proprietary fund products and other investments	$280	$—	$(100)	$ —	$—	$ (1)	$179
Equity method investments in proprietary fund products	12,240	—	—	—	—	(635)	11,605
Investments in partnerships, LLCs and other	21,952	7,038	—	—	—	(521)	28,469
Equity method investments in partnerships and LLCs	143,107	24,174	(1,636)	(619)	—	(4,364)	160,662
Other investments	1,254	—	—	(159)	—	(962)	133
	$178,833	$31,212	$(1,736)	$ (778)	$—	$ (6,483)	$201,048

	Value as of March 31, 2012	Purchases	Sales	Redemptions/ Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of September 30, 2012
Assets:							
Equity method investments in proprietary fund products	$11,778	$—	$—	$—	$—	$(73)	$11,705
Investments in partnerships, LLCs and other	28,763	—	(788)	(566)	—	632	28,041
Equity method investments in partnerships and LLCs	166,438	212	(842)	(52,066)	—	15,552	129,294
Other investments	124	—	—	—	—	7	131
	$207,103	$212	$(1,630)	$(52,632)	$—	$16,118	$169,171

	Value as of March 31, 2011	Purchases	Sales	Redemptions/Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of September 30, 2011
Assets:							
Trading proprietary fund products and other investments	$11,378	$—	$(11,741)	$ —	$—	$ 542	$179
Equity method investments in proprietary fund products	12,167	—	—	—	—	(562)	11,605
Investments in partnerships, LLCs and other	22,167	6,932	—	(109)	—	(521)	28,469
Equity method investments in partnerships and LLCs	153,931	25,504	(3,293)	(12,697)	—	(2,783)	160,662
Other investments	282	—	—	(159)	—	10	133
	$199,925	$32,436	$(15,034)	$ (12,965)	$—	$ (3,314)	$201,048

Realized and unrealized gains and losses recorded for Level 3 investments are included in Other income (expense) on the Consolidated Statements of Income. Total unrealized gains (losses) for Level 3 investments relating only to those assets still held at the reporting date were $15,145 and $(6,487) for the three months ended September 30, 2012 and 2011, respectively. Total unrealized gains (losses) for Level 3 investments relating only to those assets still held at the reporting date were $16,429 and $(5,419) for the six months ended September 30, 2012 and 2011, respectively.

There were no material transfers between Level 1 and Level 2 during the three or six months ended September 30, 2012 and 2011.

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 reporting date. The following table summarizes, as of September 30, 2012, 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, 2012	
Category of Investment	Investment Strategy	September 30, 2012		March 31, 2012		Unfunded Commitments	Remaining Term
Funds-of-hedge funds	Global macro, fixed income, long/short equity, natural resources, systematic, emerging market, European hedge	$46,184	(1)	$51,251	(2)	n/a	n/a
Hedge funds	Fixed income - developed market, event driven, fixed income - hedge, relative value arbitrage, European hedge	25,163		25,460		$20,000	n/a
Private equity funds	Long/short equity	27,002	(3)	27,927	(3)	6,140	Up to 8 years
Private fund	Fixed income, residential and commercial mortgage-backed securities	63,849		89,323		n/a	6 years, subject to two one-year extensions (4)
Other	Various	2,330		2,450		n/a	Various (5)
Total		$164,528	(6)	$196,411	(6)	$26,140	

n/a-not applicable

(1) 59% monthly redemption; 41% quarterly redemption, of which 38% is subject to two-year lock-up, which expires in June 2013.

(2) 63% monthly redemption; 37% quarterly redemption, of which 36% is subject to two-year lock-up, which expires in June 2013.

(3) Liquidations are expected over the remaining term.

(4) Upon liquidation of the fund, Legg Mason's investment is expected to be fully redeemed in the quarter ended December 31, 2012.

(5) Of this balance, 4% has a remaining term of less than one year and 96% has a remaining term of 20 years.

(6) Comprised of approximately 15% and 85% of Level 2 and Level 3 assets, respectively, as of September 30, 2012 and 13% and 87% of Level 2 and Level 3 assets, respectively, as of March 31, 2012.

There are no current plans to sell any of these investments held as of September 30, 2012.

4. 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, 2012	March 31, 2012
Equipment	$156,471	$155,173
Software	216,043	205,760
Leasehold improvements	245,983	242,566
Total cost	618,497	603,499

Less: accumulated depreciation and amortization	(388,515)	(364,088)
Fixed assets, net	$229,982	$239,411

Depreciation and amortization expense included in operating income was $12,896 and $16,662 for the three months ended September 30, 2012 and 2011, respectively, and $26,471 and $33,963 for the six months ended September 30, 2012 and 2011, respectively.

5. Intangible Assets and Goodwill

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

	September 30, 2012	March 31, 2012
Amortizable asset management contracts		
Cost	$205,880	$206,411
Accumulated amortization	(179,452)	(172,974)
Net	26,428	33,437
Indefinite–life intangible assets		
Fund management contracts	3,753,688	3,753,629
Trade names	69,800	69,800
	3,823,488	3,823,429
Intangible assets, net	$3,849,916	$3,856,866

As of September 30, 2012, amortizable asset management contracts are being amortized over a weighted-average remaining life of 2.6 years.

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

Remaining 2013	$7,010
2014	11,835
2015	2,920
2016	2,663
2017	2,000
Thereafter	—
Total	$26,428

Indefinite-life fund management contracts include $2,502,000 of mutual fund contracts acquired in the Citigroup Asset Management ("CAM") acquisition, principally managed by ClearBridge Advisors LLC and Western Asset Management Company, which as of Legg Mason's most recent annual impairment test as of December 31, 2011, had an assessed fair value that exceeded its carrying value by 5%. Given the current uncertainty regarding future market conditions, 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 asset could be deemed to be impaired by a material amount.

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

	Gross Book Value	Accumulated Impairment	Net Book Value
Balance as of March 31, 2012	$2,436,945	$(1,161,900)	$1,275,045
Impact of excess tax basis amortization	(10,792)	—	(10,792)
Other, including changes in foreign exchange rates	(8,107)	—	(8,107)
Balance as of September 30, 2012	$2,418,046	$(1,161,900)	$1,256,146

6. Short-Term Borrowings and 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.

In May 2012, Legg Mason announced a new capital plan that included the refinancing of its 2.5% Convertible Senior Notes (the "Notes”) due 2015, as further discussed below. The refinancing was effected through the issuance of $650,000 of 5.5% senior notes, the net proceeds of which, together with cash on hand and $250,000 of remaining borrowing capacity under an existing revolving credit facility, were used to repurchase the entire $1,250,000 face amount of the Notes.

Also, pursuant to the new capital plan, in June 2012, Legg Mason entered into a new unsecured credit agreement which provides for a new undrawn $500,000 revolving credit facility and a $500,000 term loan, also further discussed below. The proceeds of the term loan were used to repay the $500,000 of outstanding borrowings under the previous revolving credit facility, which was then terminated. As of March 31, 2012, there was $250,000 outstanding under the previous revolving credit facility, which had a then effective interest rate of 2.9%.
The new $500,000 revolving credit facility may be increased by an aggregate amount of up to $250,000, subject to the approval of the lenders, and expires in June 2017. The new revolving credit facility has an interest rate of LIBOR plus 150 basis points and an annual commitment fee of 20 basis points. The interest rate may change in the future based on changes in Legg Mason's credit ratings. This revolving credit facility is available to fund working capital needs and for general corporate purposes. There were no borrowings outstanding under this facility as of September 30, 2012.
The revolving credit facility and term loan have standard financial covenants, including a maximum net debt to EBITDA ratio (as defined in the documents) of 2.5 to 1 and minimum EBITDA to interest ratio (as defined in the documents) of 4.0 to 1. As of September 30, 2012, Legg Mason's net debt to EBITDA ratio was 1.4 to 1 and EBITDA to interest expense ratio was 12.4 to 1, and therefore, Legg Mason has maintained compliance with the applicable covenants.

Five-year Term Loan

The $500,000 term loan entered into in conjunction with the unsecured credit agreement noted above can be repaid at any time and will be due in four annual installments of $50,000, beginning in June 2013, with the remainder to be repaid at maturity in June 2017. The term loan bears interest at LIBOR plus 150 basis points, which may change in the future based on changes in Legg Mason's credit ratings. The effective interest rate as of September 30, 2012 was 1.7%.

5.5% Senior Notes

The $650,000 5.5% Senior Notes (the "Senior Notes") due May 2019, were sold at a discount of $6,754, which is being amortized to interest expense over the seven-year term. The Senior Notes are subject to certain nonfinancial covenants and registration rights, which if not complied with, requires additional interest up to 0.50% over the stated rate. As of September 30, 2012, the interest rate was 5.75%, which includes 0.25% associated with the registration status of the Senior Notes. The Senior Notes can be redeemed at any time prior to their 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 0.50%, together with any related accrued and unpaid interest.

2.5% Convertible Senior Notes and Related Hedge Transactions

The terms of the repurchase of the Notes in May 2012 noted above included their repayment at par plus accrued interest, a prepayment fee of $6,250, and a non-cash exchange of warrants (the “Warrants”) to the holders of the Notes that replicate and extend the contingent conversion feature of the Notes. The cash payment of $1,256,250 to repurchase the Notes was allocated between their liability and equity components based on a liability fair value of $1,193,971, determined using a then current market interest rate of 4.1%, resulting in a loss on debt extinguishment of $68,975, including $7,851 of accelerated deferred issue costs. The remaining balance of the cash payment was allocated to the equity component of the Notes for a $62,279 reduction of additional paid-in capital, offset by related tax benefits of $31,446. The $1,193,971 amount of cash repurchase payment allocated to the liability component of the Notes upon their extinguishment exceeds the initial allocated value at issuance of $977,933, requiring the Consolidated Statements of Cash Flows for the six months ended September 30, 2012 to include an allocation of the $216,038 excess to operating activities.

The Warrants issued to the holders of the Notes in connection with the repurchase of the Notes provide for the purchase, in the aggregate and subject to adjustment, of 14,205 shares of Legg Mason common stock, on a net share settled basis, at an exercise price of $88 per share. Upon exercise of the Warrants, Legg Mason will be required to deliver to the holders of the Warrants, at its election, either shares of its common stock or cash, in an amount based on the excess of the market price per share of its common stock over the exercise price of the Warrants. The Warrants expire in July 2017. Legg Mason has had the ability to settle its obligations under the Warrants with Legg Mason common stock. Accordingly, the Warrants are accounted for as equity.

In connection with the extinguishment of the Notes, the hedge transactions (purchased call options and warrants) executed in connection with the initial issuance of the Notes were also terminated.

The accreted value of long-term debt consists of the following:

	September 30, 2012			March 31, 2012
	Current Accreted Value	Unamortized Discount	Maturity Amount	Accreted Value
5.5% senior notes	$643,590	$6,410	$650,000	$—
Five-year term loan	500,000	—	500,000	—
Other term loans	9,249	—	9,249	9,883
2.5% convertible senior notes	—	—	—	1,127,009
Subtotal	1,152,839	6,410	1,159,249	1,136,892
Less: current portion	58,372	—	58,372	1,278
Total	$1,094,467	$6,410	$1,100,877	$1,135,614

As of September 30, 2012, the aggregate maturities of long-term debt, based on their contractual terms, are as follows:

Remaining 2013	$8,373
2014	50,438
2015	50,438
2016	50,000
2017	50,000
Thereafter	950,000
Total	$1,159,249

At September 30, 2012, the estimated fair value of long-term debt was $1,206,218, and is classified as Level 2 in the fair value hierarchy.

Prior to the repurchase of the Notes in May 2012, as previously discussed, Legg Mason was accreting the carrying value of the Notes to the principal amount at maturity using an interest rate of 6.5% (the effective borrowing rate for non-convertible debt at the time of issuance) over its expected life of seven years, resulting in interest expense of $9,741 for the three months ended September 30, 2011, and $5,839 and $19,230 for the six months ended September 30, 2012 and 2011, respectively.

7. Stock-Based Compensation

Legg Mason's stock-based compensation includes stock options, employee stock purchase plans, restricted stock awards and units, performance shares payable in common stock, and deferred compensation payable in stock. Shares available for issuance under the active equity incentive stock plan as of September 30, 2012, were 10,543. 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 to five years and expire within eight to ten years from the date of grant.

Compensation expense relating to stock options for the three months ended September 30, 2012 and 2011, was $2,619 and $3,500, respectively, and for the six months ended September 30, 2012 and 2011, was $5,902 and $7,681, respectively.

Stock option transactions during the six months ended September 30, 2012, and 2011, respectively, are summarized below:

	Six Months Ended September 30,			
	2012		2011	
	Number of shares	Weighted-average exercise price per share	Number of shares	Weighted-average exercise price per share
Options outstanding at March 31	5,624	$57.78	5,419	$59.82
Granted	966	23.72	810	33.99
Exercised	(1)	23.72	(8)	25.76
Canceled/forfeited	(578)	56.37	(305)	47.95
Options outstanding at September 30	6,011	$52.44	5,916	$56.95

At September 30, 2012, options were exercisable on 3,586 shares, with a weighted-average exercise price of $68.60 and a weighted-average remaining contractual life of 3.1 years. Unamortized compensation cost related to unvested options (2,425 shares) at September 30, 2012, was $22,912 and is expected to be recognized over a weighted-average period of 1.8 years.

The weighted-average fair value of stock option grants during the six months ended September 30, 2012 and 2011, using the Black-Scholes option pricing model, was $9.47 and $13.13 per share, respectively.

The following weighted-average assumptions were used in the model for grants in fiscal 2013 and 2012:

	Six Months Ended September 30,	
	2012	2011
Expected dividend yield	1.44 %	1.39 %
Risk-free interest rate	0.81 %	1.95 %
Expected volatility	51.80 %	47.16 %
Expected life (in years)	5.02	5.12

Compensation expense relating to restricted stock and restricted stock units for the three months ended September 30, 2012 and 2011, was $11,715 and $8,533, respectively, and for the six months ended September 30, 2012 and 2011, was $21,022 and $16,608, respectively.

Compensation expense for the three and six months ended September 30, 2012 includes approximately $1,800 of accelerated stock-based net compensation costs associated with Legg Mason's Chief Executive Officer stepping down in September 2012.

Restricted stock and restricted stock unit transactions during the six months ended September 30, 2012 and 2011, respectively, are summarized below:

	Six Months Ended September 30,			
	2012		2011	
	Number of shares	Weighted-average grant date value	Number of shares	Weighted-average grant date value
Unvested shares at March 31	2,873	$ 33.83	2,637	$ 33.01
Granted	2,183	24.04	1,315	33.79
Vested	(903)	32.26	(700)	33.86
Canceled/forfeited	(37)	29.74	(42)	33.06
Unvested shares at September 30	4,116	$ 29.02	3,210	$ 33.14

Unamortized compensation cost related to unvested restricted stock and restricted stock unit awards at September 30, 2012 of $92,112 is expected to be recognized over a weighted-average period of 1.8 years. In connection with the change in Legg

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Mason's Chief Executive Officer, in September 2012 325 shares of restricted stock were granted to certain executives and key employees, with an aggregate value of $8,400. These shares vest on March 31, 2014, and are intended to retain and motivate these employees.

Compensation expense relating to the stock purchase plan and deferred compensation payable in stock for the three months ended September 30, 2012 and 2011, was $92 and $109, respectively, and for the six months ended September 30, 2012 and 2011, was $236 and $284, respectively.

During the six months ended September 30, 2012 and 2011, non-employee directors were granted 16 and 12 restricted stock units and 35 and 31 shares of common stock at a fair value of $1,250 and $1,375, respectively. As of September 30, 2012 and 2011, non-employee directors held 112 and 193 stock options, respectively, which are included in the outstanding options presented in the table above. As of September 30, 2012 and 2011, non-employee directors held 90 and 74 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. During the six months ended September 30, 2012 and 2011, non-employee directors did not exercise any stock options and no restricted stock units were distributed. During the six months ended September 30, 2012 and 2011, there were 72 and 27 non-employee director stock options canceled or forfeited, respectively.

During fiscal 2012, Legg Mason established a long-term incentive plan (the "LTIP") under its equity incentive plan, which provides an additional element of compensation that is based on performance. Under the LTIP, executive officers were granted cash value performance units in the June 2011 quarter and the September 2012 quarter that will vest at the end of their respective three year periods based upon Legg Mason's cumulative adjusted earnings per share over the respective periods. Awards granted under the LTIP may be settled in cash and/or shares of Legg Mason common stock, at the discretion of Legg Mason. The estimated payout amounts of the awards, if any, are expensed over the future vesting periods based on a probability assessment of the expected outcome under the LTIP provisions.

As part of the Company's streamlining initiative, as further discussed in Note 11, the employment of certain recipients of stock option and restricted stock awards has been terminated. The termination benefits extended to these employees included accelerated vesting of their unvested equity incentive awards to January 1, 2012, which precedes dates under the original terms of the awards. The portion of the awards subject to accelerated vesting was revalued and expensed over the new vesting period, the impact of which is included above in fiscal year 2012.

8. 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, 2012, the minimum annual aggregate rentals under operating leases and service agreements are as follows:

Remaining 2013	$75,216
2014	125,876
2015	115,892
2016	103,671
2017	93,843
Thereafter	510,693
Total	$1,025,191

The minimum rental commitments shown above have not been reduced by $158,496 for minimum sublease rentals to be received in the future under non-cancelable subleases, of which approximately 46% is due from one counterparty. If a sub-tenant defaults on a sublease, Legg Mason may incur operating charges to reflect expected future sublease rentals at reduced amounts, as a result of the current commercial real estate market.

The above minimum rental commitments include $930,855 in real estate and equipment leases and $94,336 in service and maintenance agreements.

As of September 30, 2012, Legg Mason had commitments to invest approximately $36,891 in limited partnerships that make private investments. These commitments are expected to be funded as required through the end of the respective investment periods ranging through fiscal 2018.

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 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, 2012 and 2011, 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.

One of Legg Mason's asset management subsidiaries was named as the defendant in a lawsuit filed by a former institutional client in late August 2011. The complaint alleges breach of contract and breach of fiduciary duty arising from investments in the former client's account allegedly being inconsistent with the account's objectives, and seeks damages in excess of $90,000. Legg Mason believes that the claims are without merit and intends to defend the matter vigorously. Discovery in the case is ongoing, and a pretrial conference, previously scheduled for April 2013, has been moved to July 2013. Because of the preliminary status of the matter, Legg Mason cannot estimate the possible loss or range of loss from this matter, if any. In addition, although Legg Mason believes that this matter would likely be covered by insurance policies that may substantially mitigate the amount of any eventual loss, as is not unusual with litigation at this point in the process, there can be no assurance the action will not have a material effect on Legg Mason's financial position, results of operations or cash flows.

Another matter relates to two related regulatory investigations of one of Legg Mason's asset management subsidiaries regarding its compliance with applicable legal requirements with respect to an investment made for certain client accounts. Legg Mason believes that it handled the investment appropriately and is continuing discussions to resolve the matter. Although the ultimate resolution is unknown, Legg Mason has reserved $4 million as a probable outcome. Legg Mason also believes this matter would likely be covered by insurance policies that may substantially mitigate the amount of any eventual loss, but as is not unusual with regulatory proceedings at this point in the process, there can be no assurance that this matter will not have a material effect on Legg Mason's financial position, results of operations or cash flows.

Legg Mason cannot estimate the reasonably possible additional loss or range of loss associated with the ultimate resolution of the two matters above, or certain other matters described above as customer complaints, legal actions, inquires, 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 very 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, 2012, 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 or insurance reimbursement.

9. 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.

In May 2012, as part of a new capital plan, Legg Mason's Board of Directors authorized $1,000,000 for additional purchases of Legg Mason common stock, as well as the completion of the repurchase of the then remaining approximate $155,000 of Legg Mason common stock previously authorized. The new capital plan authorizes using up to 65% of cash generated from future operations, beginning in fiscal 2013, to purchase shares of Legg Mason common stock.

During the three and six months ended September 30, 2012, Legg Mason purchased and retired 3,554 and 9,727 shares of its common stock for $90,071 and $245,071, respectively, through open market purchases, which completed the repurchase of its common stock under the previous authorization, and began purchases under the new authorization. These repurchases reduced weighted-average shares outstanding by 7,718 and 4,953 shares for the three and six months ended September 30, 2012, respectively. The par value of the shares repurchased is charged to common stock, with the excess of the purchase price over par first charged against additional paid-in capital, with the remaining balance, if any, charged against retained earnings.

In connection with the change in its Chief Executive Officer in September 2012, Legg Mason issued 325 shares of restricted stock, during the three months ended September 30, 2012 to certain executives and key employees to retain and motivate these employees. During the six months ended September 30, 2012, Legg Mason issued 2,167 shares of restricted stock related to its annual incentive awards and the retention awards mentioned above. Of the shares issued in the six month period, 1,917 and 1,427 shares are included in weighted-average shares outstanding for the three and six months ended September 30, 2012, respectively. Legg Mason issued 56 and 1,303 shares, respectively, of restricted stock related to its annual incentive awards, during the three and six months ended September 30, 2011. Of the shares issued in the six month period, 1,286 and 960 shares are included in weighted-average shares outstanding for the three and six months ended September 30, 2011, respectively.

In June 2011, Legg Mason issued 1,830 shares of common stock upon the exercise of purchase contracts on the remaining outstanding Equity Units issued in May 2008. Of these shares, 1,830 and 930 shares are included in weighted-average shares outstanding for the three and six months ended September 30, 2011.

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

	Three Months Ended September 30,			
	2012		2011	
	Basic	Diluted	Basic	Diluted
Weighted-average basic shares outstanding	134,098	134,098	143,877	143,877
Potential common shares:				
Employee stock options	—	30	—	54
Weighted-average diluted shares	134,098	134,128	143,877	143,931
Net Income	$81,095	$81,095	$57,383	$57,383
Less: Net income attributable to noncontrolling interests	298	298	719	719
Net Income Attributable to Legg Mason, Inc.	$80,797	$80,797	$56,664	$56,664
Net Income per Share Attributable to Legg Mason, Inc. Common Shareholders	$0.60	$0.60	$0.39	$0.39

	Six Months Ended September 30,			
	2012		2011	
	Basic	Diluted	Basic	Diluted
Weighted-average basic shares outstanding	136,396	136,396	146,529	146,529
Potential common shares:				
Employee stock options	—	29	—	96
Weighted-average diluted shares	136,396	136,425	146,529	146,625
Net Income	$68,111	$68,111	$119,081	$119,081
Less: Net income (loss) attributable to noncontrolling interests	(3,228)	(3,228)	2,465	2,465
Net Income Attributable to Legg Mason, Inc.	$71,339	$71,339	$116,616	$116,616
Net Income per Share Attributable to Legg Mason, Inc. Common Shareholders	$0.52	$0.52	$0.80	$0.80

The diluted EPS calculation for the three and six months ended September 30, 2012 and 2011, excludes any potential common shares issuable under the Notes extinguished in May 2012, or the Warrants exchanged for the Note conversion feature, because the market price of Legg Mason common stock had not exceeded the price at which conversion/exercise would be dilutive using the treasury stock method. Also, for the three and six months ended September 30, 2011, warrants issued in connection with the convertible note hedge transactions associated with the issuance of the 2.5% Convertible Senior Notes are excluded from the calculation of diluted earnings per share because the effect would be antidilutive.

Options to purchase 6,011 and 5,379 shares for the three months ended September 30, 2012 and 2011, respectively, and 5,897 and 7,144 shares for the six months ended September 30, 2012 and 2011, respectively, were not included in the computation of diluted earnings per share because the presumed proceeds from exercising such options, including related income tax benefits, exceed the average price of the common shares for the period and therefore the options are deemed antidilutive.

10. 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, euro, Japanese yen, Singapore dollar, and British pound. In the Consolidated Balance Sheets, Legg Mason nets the fair value of certain foreign currency forwards executed with the same counterparty where Legg Mason has both the legal right and intent to settle the contracts on a net basis. Legg Mason has not designated any derivatives as hedging instruments during the periods ended September 30, 2012, March 31, 2012, and September 30, 2011.

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 $2,317 and $1,919 as of September 30, 2012 and March 31, 2012, respectively.

The following table presents the fair values as of September 30, 2012 and March 31, 2012, classified as Other assets and Other liabilities, of derivative instruments not designated as hedging instruments for accounting purposes:

	September 30, 2012		March 31, 2012	
	Assets	Liabilities	Assets	Liabilities
Currency forward contracts	$527	$897	$38	$685
Futures contracts	412	10	46	201
Total	$939	$907	$84	$886

The following table presents gains (losses) recognized on derivative instruments for the three and six months ended September 30, 2012 and 2011:

		Three months ended September 30,			
		2012		2011	
	Income Statement Classification	Gains	Losses	Gains	Losses
Currency forward contracts for:					
Operating activities	Other expense	$314	$(1,132)	$5,047	$(2,835)
Seed capital investments	Other non-operating income (expense)	8	(258)	401	(29)
Futures contracts for seed capital investments	Other non-operating income (expense)	434	(1,352)	5,964	(566)
Total		$756	$(2,742)	$11,412	$(3,430)

		Six months ended September 30,			
		2012		2011	
	Income Statement Classification	Gains	Losses	Gains	Losses
Currency forward contracts for:					
Operating activities	Other expense	$1,297	$(1,087)	$4,805	$(3,456)
Seed capital investments	Other non-operating income (expense)	143	(136)	299	(65)
Futures contracts for seed capital investments	Other non-operating income (expense)	1,422	(1,868)	6,294	(729)
Total		$2,862	$(3,091)	$11,398	$(4,250)

11. Restructuring

In May 2010, Legg Mason announced a plan to streamline its business model to drive increased profitability and growth that primarily involved transitioning certain shared services to its investment affiliates which are closer to actual client relationships. This plan involved headcount reductions in operations, technology, and other administrative areas, which were partially offset by headcount increases at the affiliates, and enabled Legg Mason to eliminate a portion of its corporate office space that was primarily dedicated to operations and technology employees. The initiative was completed as of March 31, 2012.

Total transition-related costs were $127,500, including non-cash charges of $30,841, through completion of the plan in

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March 2012. Of the total transition-related costs incurred, $79,686 were related to charges for employee termination benefits and retention incentives during the transition period, and were recorded in Transition-related compensation in the Consolidated Statements of Income. The remainder represents other costs, including charges for consolidating leased office space, early contract terminations, asset disposals, and professional fees, which were recorded in the appropriate operating expense classifications. Charges for transition-related costs were $15,138 and $28,858 for the three and six months ended September 30, 2011, respectively, which primarily represent costs for severance and retention incentives.

The table below presents a summary of changes in the transition-related liability from March 31, 2011 through September 30, 2012:

	Severance and retention incentives	Lease loss accruals and other	Total
Balance as of March 31, 2011	$23,211	$5,835	$29,046
Accrued charges	29,096	25,916 (1)	55,012
Payments	(51,140)	(16,121)	(67,261)
Balance as of March 31, 2012	1,167	15,630	16,797
Payments and other	(1,165)	(9,209)	(10,374)
Balance as of September 30, 2012	$2	$6,421	$6,423

(1) Includes lease loss accruals of $17,983 for space permanently abandoned.

12. Variable Interest Entities and Consolidation of Investment Vehicles

In the normal course of its business, Legg Mason sponsors and is the manager of various types of investment vehicles. Certain of these investment vehicles are considered to be variable interest entities (“VIEs”) while others are considered to be voting rights entities (“VREs”) subject to traditional consolidation concepts based on ownership rights. For its services, Legg Mason is entitled to receive management fees and may be eligible, under certain circumstances, to receive additional subordinate 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. Investment vehicles that are considered VREs are consolidated if Legg Mason has a controlling financial interest in the investment vehicle, absent substantive kick-out rights.

Financial Accounting Standards Board Interpretation No. 46(R) (Accounting Standards Update 2010-10, "Amendments to Statement 167 for Certain Investment Funds")

For most sponsored investment funds, 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 a 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 ownership, guarantees and implied relationships.

Legg Mason concluded it was the primary beneficiary of one sponsored investment fund VIE, and also held a controlling financial interest in one sponsored investment fund VRE, both of which were consolidated as of September 30, 2012, March 31, 2012 and September 30, 2011. Effective December 31, 2011, a controlling financial interest of $20,814 in a second sponsored investment fund VRE, previously consolidated by Legg Mason, was redeemed. Accordingly, the fund was deconsolidated by Legg Mason and the fund's balance sheet amounts have been excluded from Legg Mason's consolidated balance sheet as of March 31, 2012, but income statement and cash flow amounts for the fund have been included in Legg Mason's consolidated income and cash flow statements for the six months ended September 30, 2011.

Statement of Financial Accounting Standards No. 167 (Accounting Standards Codification Topic 810, "Consolidation")

For other sponsored investment funds that do not meet certain criteria, if Legg Mason has a significant variable interest, it determines it is the primary beneficiary of the VIE if it has both the power to direct the activities of the 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 the VIE.

Legg Mason concluded that it was the primary beneficiary of one of two CLOs in which it has a variable interest. Although it holds no equity interest in either of these investment vehicles, it had both the power to control and had a significant variable interest in one CLO because of the level of its expected subordinated fees. As of September 30, 2012, March 31, 2012 and September 30, 2011, the balances related to this CLO were consolidated on the Company's consolidated financial statements. Under the terms of the original collateral management agreement, this CLO has now concluded its reinvestment period, with purchases of new collateral assets precluded and future proceeds may be applied to the reduction of its debt. The other CLO is not consolidated as its level of expected subordinated fees is insignificant.
Legg Mason's investment in CIVs as of September 30, 2012 and March 31, 2012, was $36,821 and $38,919, respectively, which represents its maximum risk of loss, excluding uncollected advisory fees. The assets of these CIVs are primarily comprised of investment securities. Investors and creditors of these CIVs have no recourse to the general credit or assets of Legg Mason beyond its investment in these funds.

The following tables reflect the impact of CIVs on the Consolidated Balance Sheets as of September 30, 2012 and March 31, 2012, respectively, and the Consolidated Statements of Income for the three and six months ended September 30, 2012 and 2011, respectively:
Consolidating Balance Sheets

	September 30, 2012				March 31, 2012			
	Balance Before Consolidation of CIVs	CIVs	Eliminations	Consolidated Totals	Balance Before Consolidation of CIVs	CIVs	Eliminations	Consolidated Totals
Current assets	$1,810,259	$58,216	$(37,215)	$1,831,260	$2,439,162	$57,714	$(39,408)	$2,457,468
Non-current assets	5,753,759	289,880	—	6,043,639	5,801,680	296,599	—	6,098,279
Total assets	$7,564,018	$348,096	$(37,215)	$7,874,899	$8,240,842	$354,313	$(39,408)	$8,555,747
Current liabilities	$598,673	$1,035	$(394)	$599,314	$971,804	$4,467	$(489)	$975,782
Long-term debt of CIVs	—	277,309	—	277,309	—	271,707	—	271,707
Other non-current liabilities	1,516,713	3,514	—	1,520,227	1,603,064	3,872	—	1,606,936
Total liabilities	2,115,386	281,858	(394)	2,396,850	2,574,868	280,046	(489)	2,854,425
Redeemable non-controlling interests	1,398	—	20,151	21,549	996	—	23,035	24,031
Total stockholders' equity	5,447,234	66,238	(56,972)	5,456,500	5,664,978	74,267	(61,954)	5,677,291
Total liabilities and equity	$7,564,018	$348,096	$(37,215)	$7,874,899	$8,240,842	$354,313	$(39,408)	$8,555,747

Consolidating Statements of Income (Loss)

	Three Months Ended September 30, 2012				September 30, 2011			
	Balance Before Consolidation of CIVs	CIVs	Eliminations	Consolidated Totals	Balance Before Consolidation of CIVs	CIVs	Eliminations	Consolidated Totals
Total operating revenues	$640,884	$—	$(589)	$640,295	$670,522	$—	$(625)	$669,897
Total operating expenses	560,335	815	(589)	560,561	562,785	885	(625)	563,045
Operating income (loss)	80,549	(815)	—	79,734	107,737	(885)	—	106,852
Total other non-operating income (expense)	16,763	1,503	(508)	17,758	(52,597)	3,081	(1,559)	(51,075)
Income (loss) before income tax provision (benefit)	97,312	688	(508)	97,492	55,140	2,196	(1,559)	55,777
Income tax provision (benefit)	16,397	—	—	16,397	(1,606)	—	—	(1,606)
Net income (loss)	80,915	688	(508)	81,095	56,746	2,196	(1,559)	57,383
Less: Net income attributable to noncontrolling interests	118	—	180	298	82	—	637	719
Net income (loss) attributable to Legg Mason, Inc.	$80,797	$688	$(688)	$80,797	$56,664	$2,196	$(2,196)	$56,664

	Six Months Ended September 30, 2012				September 30, 2011			
	Balance Before Consolidation of CIVs	CIVs	Eliminations	Consolidated Totals	Balance Before Consolidation of CIVs	CIVs	Eliminations	Consolidated Totals
Total operating revenues	$1,272,161	$—	$(1,174)	$1,270,987	$1,388,682	$—	$(1,677)	$1,387,005
Total operating expenses	1,114,858	1,492	(1,174)	1,115,176	1,179,417	2,047	(1,677)	1,179,787
Operating income (loss)	157,303	(1,492)	—	155,811	209,265	(2,047)	—	207,218
	(74,266)	(2,632)	598	(76,300)	(66,229)	8,183	(3,830)	(61,876)

Total other non-operating income (expense)								
Income (loss) before income tax provision (benefit)	83,037	(4,124)	598	79,511	143,036	6,136	(3,830)	145,342
Income tax provision (benefit)	11,400	—	—	11,400	26,261	—	—	26,261
Net income (loss)	71,637	(4,124)	598	68,111	116,775	6,136	(3,830)	119,081
Less: Net income (loss) attributable to noncontrolling interests	298	—	(3,526)	(3,228)	159	—	2,306	2,465
Net income (loss) attributable to Legg Mason, Inc.	$71,339	$(4,124)	$4,124	$71,339	$116,616	$6,136	$(6,136)	$116,616

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Other non-operating income (expense) includes interest income, interest expense and net gains (losses) on investments and long-term debt determined on an accrual basis.

The consolidation of CIVs has no impact on Net Income Attributable to Legg Mason, Inc.

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

	As of September 30, 2012			
	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets:				
Trading investments:				
Hedge funds	$1,524	$6,237	$21,751	$29,512
Investments:				
CLO loans	—	254,265	—	254,265
CLO bonds	—	10,630	—	10,630
Private equity funds	—	—	23,237	23,237
Total investments	—	264,895	23,237	288,132
	$1,524	$271,132	$44,988	$317,644
Liabilities:				
CLO debt	$—	$—	$(277,309)	$(277,309)
Derivative liabilities	—	(3,514)	—	(3,514)
	$—	$(3,514)	$(277,309)	$(280,823)

	As of March 31, 2012			
	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets:				
Trading investments:				
Hedge funds	$1,016	$6,443	$24,116	$31,575
Investments:				
CLO loans	—	260,690	—	260,690
CLO bonds	—	9,092	—	9,092
Private equity funds	—	—	25,071	25,071
Total investments	—	269,782	25,071	294,853
	$1,016	$276,225	$49,187	$326,428
Liabilities:				
CLO debt	$—	$—	$(271,707)	$(271,707)
Derivative liabilities	—	(3,872)	—	(3,872)
	$—	$(3,872)	$(271,707)	$(275,579)

Except for the CLO debt, substantially all of the above financial instruments where valuation methods rely on other than observable market inputs as a significant input utilize the NAV practical expedient, such that measurement uncertainty has little relevance. The following table provides a summary of qualitative information relating to the valuation of CLO debt:

Value as of September 30, 2012	Valuation technique	Unobservable input	Range (weighted average)
$(277,309)	Discounted cash flow	Discount rate	1.5 % - 16.0% (2.9%)
		Default rate	2.5 % - 4.0% (3.4%)
		Constant prepayment rate	15.0%

Significant increases (decreases) in any of these inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, both the constant rate of prepayment and default rate are driven by market conditions related to interest rates, credit ratings, and other factors. Each of the inputs noted could move independently depending on specific market conditions, making it possible for varying market conditions to drive changes in these inputs with a positive, negative, or zero correlation.

The changes in assets and (liabilities) of CIVs measured at fair value using significant unobservable inputs (Level 3) are presented in the tables below:

	Value as of June 30, 2012	Purchases	Sales	Transfers In	Transfers Out	Realized and unrealized gains/(losses), net	Value as of September 30, 2012
Assets:							
Hedge funds	$22,207	$62	$(1,087)	$—	$—	$ 569	$21,751
Private equity funds	24,188	—	(1,152)	—	—	201	23,237
	$46,395	$62	$(2,239)	$—	$—	$ 770	$44,988
Liabilities:							
CLO debt	$(273,560)	$—	$—	$—	$—	$ (3,749)	$(277,309)
Total realized and unrealized gains (losses), net						$ (2,979)	

	Value as of June 30, 2011	Purchases	Sales	Transfers In	Transfers Out	Realized and unrealized gains, net	Value as of September 30, 2011
Assets:							
Hedge funds	$35,718	$1,647	$(3,871)	$—	$(1,057)	$890	$33,327
Private equity funds	19,792	3,396	—	—	—	325	23,513
	$55,510	$5,043	$(3,871)	$—	$(1,057)	$1,215	$56,840
Liabilities:							
CLO debt	$(278,195)	$—	$—	$—	$—	$10,481	$(267,714)
Total realized and unrealized gains, net						$11,696	

	Value as of March 31, 2012	Purchases	Sales	Transfers In	Transfers Out	Realized and unrealized gains/(losses), net	Value as of September 30, 2012
Assets:							
Hedge funds	$24,116	$496	$(1,917)	$—	$—	$(944)	$21,751
Private equity funds	25,071	—	(2,030)	—	—	196	23,237
	$49,187	$496	$(3,947)	$—	$—	$(748)	$44,988
Liabilities:							
CLO debt	$(271,707)	$—	$—	$—	$—	$(5,602)	$(277,309)
Total realized and unrealized gains (losses), net						$(6,350)	

	Value as of March 31, 2011	Purchases	Sales	Transfers In	Transfers Out	Realized and unrealized gains, net	Value as of September 30, 2011
Assets:							
Hedge funds	$34,272	$10,699	$(15,507)	$1,057	$(1,057)	$3,863	$33,327
Private equity funds	17,879	3,974	—	—	—	1,660	23,513
	$52,151	$14,673	$(15,507)	$1,057	$(1,057)	$5,523	$56,840
Liabilities:							
CLO debt	$(278,320)	$—	$—	$—	$—	$10,606	$(267,714)
Total realized and unrealized gains, net						$16,129	

Realized and unrealized gains and losses recorded for Level 3 assets and liabilities of CIVs are included in Other non-operating income (expense) of CIVs on the Consolidated Statements of Income. Total unrealized gains (losses) for Level 3 investments and liabilities of CIVs relating only to those assets and liabilities still held at the reporting date were $(3,471) and $9,990 for the three months ended September 30, 2012 and 2011, respectively. Total unrealized gains (losses) for Level 3 investments and liabilities of CIVs relating only to those assets and liabilities still held at the reporting date were $(6,963) and $10,935 for the six months ended September 30, 2012 and 2011, respectively.

There were no transfers between Level 1 and Level 2 during the six months ended September 30, 2012 and 2011.

The NAV values used as a practical expedient by CIVs have been provided by the investees and have been derived from the fair values of the underlying investments as of the reporting date. The following table summarizes, as of September 30, 2012 and March 31, 2012, 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, 2012	
Category of Investment	Investment Strategy	September 30, 2012		March 31, 2012		Unfunded Commitments	Remaining Term
Hedge funds	Global macro, fixed income, long/short equity, systematic, emerging market, U.S. and European hedge	$29,512	(1)	$31,575	(2)	n/a	n/a
Private equity funds	Long/short equity	23,237	(3)	25,071	(3)	$7,444	7 years
Total		$52,749		$56,646		$7,444	

n/a – not applicable

(1) 7% daily redemption; 7% monthly redemption; 3% quarterly redemption; and 83% are subject to three to five year lock-up or side pocket provisions.

(2) 5% daily redemption; 6% monthly redemption; 5% quarterly redemption; and 84% are subject to three to five year lock-up or side pocket provisions.

(3) Liquidations are expected over the remaining term.

There are no current plans to sell any of these investments held as of September 30, 2012.

Legg Mason has elected the fair value option for certain eligible assets and liabilities, including corporate loans and debt, of the consolidated CLO. Management believes that the use of the fair value option eliminates certain timing differences and better matches the changes in fair value of assets and liabilities related to the CLO.

The following table presents the fair value and unpaid principal balance of CLO loans, bonds and debt carried at fair value under the fair value option as of September 30, 2012 and March 31, 2012:

	September 30, 2012		March 31, 2012	
CLO loans and bonds				
Unpaid principal balance	$269,200		$277,156	
Unpaid principal balance in excess of fair value	(4,305	)	(7,374	)
Fair value	$264,895		$269,782	
Unpaid principal balance of loans that are more than 90 days past due and also in nonaccrual status	$—		$2,963	
Unpaid principal balance in excess of fair value for loans that are more than 90 days past due and also in nonaccrual status	—		(1,023	)
Fair value of loans more than 90 days past due and in nonaccrual status	$—		$1,940	
CLO debt				
Principal amounts outstanding	$300,721		$300,959	
Excess unpaid principal over fair value	(23,412	)	(29,252	)
Fair value	$277,309		$271,707	

During the three and six months ended September 30, 2012, total losses of $152 and $3,416, respectively, were recognized in Other non-operating income of CIVs in the Consolidated Statements of Income related to assets and liabilities for which the fair value option was elected. During the three and six months ended September 30, 2011, total losses of $3,047 and $4,551, respectively, were recognized in Other non-operating income of CIVs in the Consolidated Statements of Income

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related to assets and liabilities for which the fair value option was elected. CLO loans and CLO debt measured at fair value have floating interest rates, therefore, substantially all of the estimated gains and losses included in earnings for the three and six months ended September 30, 2012 and 2011, were attributable to instrument specific credit risk.

The CLO debt bears interest at variable rates based on LIBOR plus a pre-defined spread, which ranges from 25 basis points to 400 basis points. All outstanding debt matures on July 15, 2018.

Total derivative liabilities of CIVs of $3,514 and $3,872 as of September 30, 2012 and March 31, 2012, respectively, are recorded in Other liabilities of CIVs. Gains and (losses) of $106 and $(305), respectively, for the three months ended September 30, 2012, and $358 and $(604), respectively, for the six months ended September 30, 2012, related to derivative liabilities of CIVs are included in Other non-operating income (loss) of CIVs. Gains and (losses) of $41,896 and $(35,025), respectively, for the three months ended September 30, 2011, and $53,986 and $(46,836), respectively, for the six months ended September 30, 2011, related to derivative assets and liabilities of CIVs are included in Other non-operating income (expense) of CIVs. There is no risk to Legg Mason in relation to the derivative assets and liabilities of the CIVs in excess of its investment in the funds, if any.

As of September 30, 2012 and March 31, 2012, for VIEs in which Legg Mason holds a variable interest or is the sponsor and holds a variable interest, but for which it was not the primary beneficiary, Legg Mason's carrying value, the related VIE assets and liabilities and maximum risk of loss were as follows:

	As of September 30, 2012			
	VIE Assets Not Consolidated	VIE Liabilities Not Consolidated	Equity Interests on the Consolidated Balance Sheet	Maximum Risk of Loss [(1)]
CLO	$392,198	$364,198	$—	$447
Public-Private Investment Program [(2)]	483,046	3,772	201	340
Other sponsored investment funds	16,203,914	92,569	51,058	86,763
Total	$17,079,158	$460,539	$51,259	$87,550

	As of March 31, 2012			
	VIE Assets Not Consolidated	VIE Liabilities Not Consolidated	Equity Interests on the Consolidated Balance Sheet	Maximum Risk of Loss [(1)]
CLO	$390,861	$362,861	$—	$442
Public-Private Investment Program [(2)]	674,520	3,213	282	282
Other sponsored investment funds	17,296,521	20,544	54,161	93,521
Total	$18,361,902	$386,618	$54,443	$94,245

(1) Includes equity investments the Company has made or is required to make and any earned but uncollected management fees.

(2) Upon liquidation of the fund, Legg Mason's investment is expected to be fully redeemed in the quarter ended December 31, 2012.

The assets of these VIEs are primarily comprised of cash and cash equivalents and investment securities, and the liabilities are primarily comprised of debt and various expense accruals. These VIEs are not consolidated because Legg Mason does not absorb a majority of each VIE's expected losses or does not receive a majority of each VIE's expected residual returns.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Legg Mason, Inc., a holding company, with its subsidiaries (which collectively comprise "Legg Mason") is a global asset management firm. Acting through our subsidiaries, we provide investment management and related services to institutional and individual clients, company-sponsored mutual funds and other investment vehicles. We offer these products and services directly and through various financial intermediaries. We have operations principally in the United States of America ("U.S.") and the United Kingdom ("U.K.") and also have offices in Australia, Bahamas, Brazil, Canada, Chile, China, Dubai, France, Germany, Italy, Japan, Luxembourg, Poland, Singapore, Spain, Switzerland and Taiwan. Terms such as "we," "us," "our," and "Company" refer to Legg Mason.

The financial services business in which we are engaged is extremely competitive. Our competition includes numerous global, national, regional and local asset management firms, broker-dealers and commercial banks. The industry has been impacted by continued economic uncertainty, the constant introduction of new products and services, and in prior years, by the consolidation of financial services firms through mergers and acquisitions. The industry in which we operate is also subject to extensive regulation under federal, state, and foreign laws. Like most firms, we have been and will continue to be impacted by regulatory and legislative changes. Responding to these changes, and keeping abreast of regulatory developments, has required us to incur costs that continue to impact our profitability.

Our financial position and results of operations are materially affected by the overall trends and conditions of the financial markets, particularly in the United States, but increasingly in the other countries in which we operate. Results of any individual period should not be considered representative of future results. Our profitability is sensitive to a variety of factors, including the amount and composition of our assets under management, and the volatility and general level of securities prices and interest rates, among other things. Sustained periods of unfavorable market conditions are likely to affect our profitability adversely. In addition, the diversification of services and products offered, investment performance, access to distribution channels, reputation in the market, attracting and retaining key employees and client relations are significant factors in determining whether we are successful in attracting and retaining clients. In the last few years, the industry has seen flows into products for which we do not currently garner significant market share. For a further discussion of factors that may affect our results of operations, refer to Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended March 31, 2012.

Our strategy is focused on three primary areas listed below. Management keeps these strategic priorities in mind when it evaluates our operating performance and financial condition. Consistent with this approach, we have also listed below the most important matters on which management currently focuses in evaluating our performance and financial condition.

- Outstanding independent investment managers:
- The investment performance of our asset management products and services compared to their benchmarks and to the performance of competitive products for the trailing 1-year, 3-year, 5-year, and 10-year periods.
- Our assets under management ("AUM"), the components of the changes in our AUM amid continued market uncertainty, the long-term trend of outflows in AUM in our recent history, the mix of our AUM among equity, fixed income, and liquidity assets, and the resulting impact of changes in AUM on our revenues.
- A corporate center that delivers strategic value:
- Promote revenue growth through strategic marketing of products to institutional clients, supported by retail and quasi-institutional (e.g., 401(k) plans) distribution globally.
- Management of expenses.
- Allocating capital for diversified growth and returning capital to shareholders as appropriate:
- The amount of excess capital we generate, and deployment of that capital through share repurchases, investments in proprietary fund products, dividends and targeted acquisitions.

The following discussion and analysis provides additional information regarding our financial condition and results of operations.

Business Environment

While the financial environment in the United States remained uncertain during the three and six months ended September 30, 2012, positive news regarding increased consumer confidence, declines in unemployment, and manufacturing growth gave indications that the economy may be rebounding, albeit at a slow rate. Despite the continuing crisis related to the European sovereign debt, all three major U.S. equity market indices, along with the Barclays Capital Global Aggregate Bond Index and the Barclays Capital U.S. Aggregate Bond Index increased for the three and six months ended September 30, 2012, as illustrated in the table below:

	% Change as of and for the three months ended September 30:		% Change as of and for the six months ended September 30:	
Indices[1]	2012	2011	2012	2011
Dow Jones Industrial Average	4.32 %	(12.09)%	1.70 %	(11.42)%
S&P 500	5.76 %	(14.33)%	2.29 %	(14.66)%
NASDAQ Composite Index	6.17 %	(12.91)%	0.80 %	(13.15)%
Barclays Capital U.S. Aggregate Bond Index	1.58 %	3.82 %	3.68 %	6.20 %
Barclays Capital Global Aggregate Bond Index	3.27 %	0.97 %	3.91 %	4.10 %

(1) Indices are trademarks of Dow Jones & Company, McGraw-Hill Companies, Inc., NASDAQ Stock Market, Inc., and Barclays Capital, respectively, which are not affiliated with Legg Mason.

During the three months ended September 30, 2012, the Federal Reserve Board held the federal funds rate at 0.25%. We expect economic challenges to persist and cannot predict how these uncertainties will impact our results.

Quarter Ended September 30, 2012, Compared to Quarter Ended September 30, 2011

Assets Under Management

Our AUM is primarily managed across the following asset classes:

Equity	Fixed Income	Liquidity
Large Cap Growth	U.S. Intermediate Investment Grade	U.S. Managed Cash
Large Cap Value	U.S. Government Intermediate	U.S. Municipal Cash
Equity Income	Global Government	
Mid Cap Core	U.S. Municipal	
Small Cap Core	U.S. Long Duration	
International Equity	Government/Credit	
Global Equity	Global Fixed Income	
Global Emerging Market Equity	Global Opportunistic Fixed Income	
	U.S. Corporate	
	U.S. Limited Duration	

The components of the changes in our AUM (in billions) for the three months ended September 30 were as follows:

	2012	2011
Beginning of period	$631.8	$662.5
Investment funds, excluding liquidity funds[1]		
Subscriptions	10.0	11.4
Redemptions	(10.5)	(14.2)
Separate account flows, net	(8.3)	(12.3)
Liquidity fund flows, net	9.0	(2.5)
Net client cash flows	0.2	(17.6)
Market performance and other [2]	20.7	(32.9)
Dispositions		