LEGG MASON, INC.
Form 10-Q
February 07, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q
(Mark One)
[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2013
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.

119,104,334 shares of common stock as of the close of business on January 30, 2014.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

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

	December 31, 2013	March 31, 2013
ASSETS		
Current Assets		
Cash and cash equivalents	$805,338	$933,036
Cash and cash equivalents of consolidated investment vehicles	15,223	46,541
Restricted cash	21,510	8,812
Receivables:		
Investment advisory and related fees	377,970	350,726
Other	72,409	72,392
Investment securities	436,747	371,080
Investment securities of consolidated investment vehicles	26,181	24,792
Deferred income taxes	76,611	85,257
Other	53,274	48,239
Other assets of consolidated investment vehicles	—	1,987
Total Current Assets	1,885,263	1,942,862
Fixed assets, net	192,045	201,819
Intangible assets, net	3,166,698	3,177,562
Goodwill	1,240,735	1,269,165
Investments of consolidated investment vehicles	119,755	210,553
Deferred income taxes	216,593	279,361
Other	183,843	187,274
Other assets of consolidated investment vehicles	695	1,064
Total Assets	$7,005,627	$7,269,660
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Liabilities		
Current Liabilities		
Accrued compensation	$364,945	$351,965
Accounts payable and accrued expenses	193,261	214,803
Current portion of long-term debt	50,438	50,438
Other	120,063	74,940
Other liabilities of consolidated investment vehicles	771	10,320
Total Current Liabilities	729,478	702,466
Deferred compensation	48,264	56,809
Deferred income taxes	147,907	161,298
Other	170,999	204,446
Other liabilities of consolidated investment vehicles	2,046	2,930
Long-term debt	1,044,801	1,094,516
Long-term debt of consolidated investment vehicles	94,370	207,835

Total Liabilities	2,237,865	2,430,300
Commitments and Contingencies (Note 9)		
Redeemable Noncontrolling Interests	21,058	21,009
Stockholders’ Equity		
Common stock, par value $.10; authorized 500,000,000 shares; issued 119,026,094 shares in December 2013 and 125,341,361 shares in March 2013	11,903	12,534
Additional paid-in capital	3,235,298	3,449,190
Employee stock trust	(30,226)	(32,623)
Deferred compensation employee stock trust	30,226	32,623
Retained earnings	1,473,133	1,304,259
Appropriated retained earnings for consolidated investment vehicle	4,059	4,829
Accumulated other comprehensive income, net	22,311	47,539
Total Stockholders’ Equity	4,746,704	4,818,351
Total Liabilities and Stockholders’ Equity	$7,005,627	$7,269,660

See Notes to Consolidated Financial Statements

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

	Three Months Ended December 31, 2013	Three Months Ended December 31, 2012	Nine Months Ended December 31, 2013	Nine Months Ended December 31, 2012
Operating Revenues				
Investment advisory fees:				
Separate accounts	$197,295	$181,755	$579,974	$547,617
Funds	381,020	360,827	1,124,170	1,080,208
Performance fees	50,748	46,395	90,115	65,240
Distribution and service fees	88,299	83,083	259,380	246,621
Other	2,730	1,840	6,722	5,201
Total Operating Revenues	720,092	673,900	2,060,361	1,944,887
Operating Expenses				
Compensation and benefits	322,553	308,248	912,936	881,002
Distribution and servicing	148,801	143,410	474,131	458,370
Communications and technology	38,702	38,400	117,069	111,861
Occupancy	30,904	31,072	82,635	88,642
Amortization of intangible assets	4,170	3,505	11,418	10,514
Impairment of intangible assets	—	734,000	—	734,000
Other	53,310	48,588	150,620	138,010
Total Operating Expenses	598,440	1,307,223	1,748,809	2,422,399
Operating Income (Loss)	121,652	(633,323)	311,552	(477,512)
Other Non-Operating Income (Expense)				
Interest income	1,681	1,646	4,691	5,300
Interest expense	(12,690)	(13,564)	(38,617)	(46,909)
Other income (expense), net, including $68,975 debt extinguishment loss in May 2012	14,622	9,926	24,369	(34,052)
Other non-operating income (expense) of consolidated investment vehicles, net	690	(3,449)	5,698	(6,080)
Total other non-operating income (expense)	4,303	(5,441)	(3,859)	(81,741)
Income (Loss) Before Income Tax Provision (Benefit)	125,955	(638,764)	307,693	(559,253)
Income tax provision (benefit)	46,004	(180,214)	90,949	(168,814)
Net Income (Loss)	79,951	(458,550)	216,744	(390,439)
Less: Net income (loss) attributable to noncontrolling interests	(1,783)	(4,680)	907	(7,908)
Net Income (Loss) Attributable to Legg Mason, Inc.	$81,734	$(453,870)	$215,837	$(382,531)
Net Income (Loss) per Share Attributable to Legg Mason, Inc. Common Shareholders:				
Basic	$0.68	$(3.45)	$1.76	$(2.84)
Diluted	$0.67	$(3.45)	$1.75	$(2.84)
Weighted Average Number of Shares Outstanding				

Basic	120,583	131,534	122,920	134,770
Diluted	121,126	131,534	123,236	134,770
Dividends Declared per Share	$0.13	$0.11	$0.39	$0.33

See Notes to Consolidated Financial Statements

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2013	2012	2013	2012
Net Income (Loss)	$79,951	$(458,550)	$216,744	$(390,439)
Other comprehensive income (loss):				
Foreign currency translation adjustment	(9,943)	(7,107)	(25,035)	(12,576)
Unrealized gains (losses) on investment securities:				
Unrealized holding gains (losses), net of tax provision (benefit) of ($40), ($30), ($139) and $14, respectively	(60)	(45)	(208)	21
Reclassification adjustment for losses included in net income	4	8	15	6
Net unrealized gains (losses) on investment securities	(56)	(37)	(193)	27
Total other comprehensive loss	(9,999)	(7,144)	(25,228)	(12,549)
Comprehensive Income (Loss)	69,952	(465,694)	191,516	(402,988)
Less: Comprehensive income (loss) attributable to noncontrolling interests	(1,783)	(4,680)	907	(7,908)
Comprehensive Income (Loss) Attributable to Legg Mason, Inc.	$71,735	$(461,014)	$190,609	$(395,080)

See Notes to Consolidated Financial Statements

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

	Nine Months Ended December 31, 2013	2012
COMMON STOCK		
Beginning balance	$12,534	$13,987
Stock options and other stock-based compensation	67	7
Deferred compensation employee stock trust	5	6
Deferred compensation, net	104	175
Employee tax withholdings by net share transactions	(44)	(30)
Shares repurchased and retired	(763)	(1,251)
Ending balance	11,903	12,894
ADDITIONAL PAID-IN CAPITAL		
Beginning balance	3,449,190	3,864,216
Stock options and other stock-based compensation	32,762	9,890
Deferred compensation employee stock trust	1,565	1,592
Deferred compensation, net	36,740	31,554
Employee tax withholdings by net share transactions	(13,910)	(7,871)
Shares repurchased and retired	(269,233)	(315,372)
Allocation from 2.5% Convertible Senior Notes repurchase, net of tax	—	(30,833)
Redeemable noncontrolling interest reclassified for management equity plan vesting	(1,816)	—
Ending balance	3,235,298	3,553,176
EMPLOYEE STOCK TRUST		
Beginning balance	(32,623)	(32,419)
Shares issued to plans	(1,570)	(1,598)
Distributions and forfeitures	3,967	696
Ending balance	(30,226)	(33,321)
DEFERRED COMPENSATION EMPLOYEE STOCK TRUST		
Beginning balance	32,623	32,419
Shares issued to plans	1,570	1,598
Distributions and forfeitures	(3,967)	(696)
Ending balance	30,226	33,321
RETAINED EARNINGS		
Beginning balance	1,304,259	1,715,395
Net Income (Loss) Attributable to Legg Mason, Inc.	215,837	(382,531)
Dividends declared	(46,963)	(43,693)
Ending balance	1,473,133	1,289,171
APPROPRIATED RETAINED EARNINGS FOR CONSOLIDATED INVESTMENT VEHICLE		
Beginning balance	4,829	12,221
Net income (loss) reclassified to appropriated retained earnings	(770)	(8,076)
Ending balance	4,059	4,145
ACCUMULATED OTHER COMPREHENSIVE INCOME, NET		
Beginning balance	47,539	71,472

Net unrealized holding gains (losses) on investment securities	(193)	27
Foreign currency translation adjustment	(25,035)	(12,576)
Ending balance	22,311	58,923
TOTAL STOCKHOLDERS' EQUITY	$4,746,704	$4,918,309

See Notes to Consolidated Financial Statements

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

	Nine Months Ended December 31,	
	2013	2012
Cash Flows from Operating Activities		
Net Income (Loss)	$216,744	$(390,439)
2.5% Convertible Senior Notes:		
Allocation of repurchase payment	—	(216,038)
Loss on extinguishment	—	68,975
Adjustments to reconcile Net Income (Loss) to net cash provided by (used in) operations:		
Impairment of intangible assets	—	734,000
Depreciation and amortization	48,243	49,807
Imputed interest for 2.5% Convertible Senior Notes	—	5,839
Accretion and amortization of securities discounts and premiums, net	2,276	2,531
Stock-based compensation	49,143	40,485
Net gains on investments	(19,898)	(29,440)
Net (gains) losses of consolidated investment vehicles	(4,066)	8,182
Deferred income taxes	83,322	(174,229)
Other	4,651	2,522
Decrease (increase) in assets:		
Investment advisory and related fees receivable	(31,678)	18,903
Net sales (purchases) of trading and other current investments	(29,646)	201,316
Other receivables	9,689	(687)
Other assets	(25,331)	1,661
Other assets of consolidated investment vehicles	34,143	(6,725)
(Decrease) increase in liabilities:		
Accrued compensation	17,254	(174,850)
Deferred compensation	(8,545)	(14,639)
Accounts payable and accrued expenses	(21,239)	(12,158)
Other liabilities	790	(23,826)
Other liabilities of consolidated investment vehicles	(10,498)	(1,514)
Cash Provided by Operating Activities	315,354	89,676
Cash Flows from Investing Activities		
Payments for fixed assets	(30,230)	(28,230)
Proceeds from sale of assets	1,351	—
Change in restricted cash	(13,196)	(1,890)
Purchases of investment securities	(3,030)	(5,300)
Proceeds from sales and maturities of investment securities	2,902	4,818
Purchases of investments by consolidated investment vehicles	(17,328)	(81,761)
Proceeds from sales and maturities of investments by consolidated investment vehicles	110,785	127,283
Cash Provided by Investing Activities	$51,254	$14,920

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

	Nine Months Ended December 31,	
	2013	2012
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	(50,439)	(9,006)
Proceeds from issuance of long-term debt	—	1,143,246
Debt issuance costs	—	(10,289)
Issuance of common stock	20,120	1,489
Employee tax withholdings by net share transactions	(13,954)	(7,901)
Repurchase of common stock	(269,996)	(316,623)
Dividends paid	(46,256)	(55,250)
Repayment of principal on long-term debt of consolidated investment vehicle	(113,851)	(32,820)
Net redemptions/distributions paid to noncontrolling interest holders	(3,444)	(2,523)
Cash Used in Financing Activities	(477,820)	(579,889)
Effect of Exchange Rate Changes on Cash	(16,486)	(1,244)
Net Decrease in Cash and Cash Equivalents	(127,698)	(476,537)
Cash and Cash Equivalents at Beginning of Period	933,036	1,382,263
Cash and Cash Equivalents at End of Period	$805,338	$905,726

See Notes to Consolidated Financial Statements

LEGG MASON, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share amounts or unless otherwise noted)
December 31, 2013
(Unaudited)

1. Interim Basis of Reporting

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

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

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

2. Significant Accounting Policies

Consolidation
In 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 (Loss) 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 Net Income (Loss), net of amounts allocated to noncontrolling interests. Also, see Notes 4 and 12 for additional information regarding the consolidation of investment vehicles.

Income Taxes
In July 2012, The U.K. Finance Act 2012 was enacted, which reduced the main U.K. corporate tax rate from 25% to 24% effective April 1, 2012 and to 23% effective April 1, 2013. In July 2013, the Finance Bill 2013 was enacted, further reducing the main U.K. corporate tax rate to 21% effective April 1, 2014 and to 20% effective April 1, 2015. The reductions in the U.K. corporate tax rate resulted in tax benefits of $19,164 and $18,075, recognized in the quarters ended September 30, 2013 and 2012, 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 (benefit) rate for the nine months ended December 31, 2013 and 2012, was reduced by 6.2 percentage points and increased by 3.2 percentage points, respectively.

Noncontrolling Interests

For consolidated investment vehicles with third-party investors ("CIVs"), the related noncontrolling interests are classified as redeemable noncontrolling interests if investors in these funds may request withdrawals at any time. There were no nonredeemable noncontrolling interests as of December 31, 2013 or March 31, 2013. As noted above, Net income (loss) attributable to noncontrolling interests in the Consolidated Statements of Income (Loss) 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 nine months ended December 31, 2013 and 2012, included the following amounts:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2013	2012	2013	2012
Net income attributable to redeemable noncontrolling interests	$779	$350	$1,677	$168
Net loss reclassified to appropriated retained earnings for consolidated investment vehicle	(2,562)	(5,030)	(770)	(8,076)
Total Income (Loss)	$(1,783)	$(4,680)	$907	$(7,908)

Redeemable noncontrolling interests as of and for the nine months ended December 31, 2013 and 2012, included the following amounts:

	Nine Months Ended December 31,	
	2013	2012
Balance, beginning of period	$21,009	$24,031
Net income attributable to redeemable noncontrolling interests	1,677	168
Net redemptions/distributions paid to noncontrolling interest holders	(3,444)	(2,523)
Additional paid-in capital reclassified for management equity plan vesting	1,816	—
Balance, end of period	$21,058	$21,676

In conjunction with the December 2012 modification of employment and other arrangements with the employees of its subsidiary, The Permal Group, Ltd. (“Permal”), Legg Mason completed implementation of a management equity plan during the quarter ended June 30, 2013. The plan better aligns the interests of Permal's management with those of Legg Mason and its shareholders, and was part of the modifications which provide for, among other things, higher margins at specified higher revenue levels. The management equity plan entitles certain key employees of Permal to participate in 15% of the future growth, if any, of the Permal enterprise value (subject to appropriate discounts) subsequent to the date of grant. Current and future grants under the plan vest 20% annually for five years, over which the related grant-date fair value will be recognized as Compensation expense in the Consolidated Statements of Income. Once vested, plan units can be put to Legg Mason for settlement at fair value, beginning one year after the holder terminates their employment. Legg Mason can also call plan units, generally post employment, for settlement at fair value. Changes in control of Legg Mason or Permal do not impact vesting, settlement or other provisions of the units. However, upon sale of substantially all of Permal's assets, the vesting of plan units would accelerate and participants would receive a fair value payment in respect of their interests under the plan. Future grants of additional plan units will dilute the participation of existing outstanding units in 15% of the future growth of the Permal enterprise value, if any, subsequent to the related future grant date, for which additional compensation cost would be incurred. Further, future grants under the plan will not entitle the plan participants, collectively, to more than an aggregate 15% of the future growth of the Permal enterprise value. Upon vesting, the grant-date fair value of vested plan units will be reflected in the Consolidated Balance Sheets as redeemable noncontrolling interests through an adjustment to additional paid-in capital. Thereafter, redeemable noncontrolling interests will continue to be adjusted to the ultimate maximum estimated redemption value over the expected term, through retained earnings adjustments. See Note 8 for additional information.

Accumulated Other Comprehensive Income

There were no significant amounts reclassified from Accumulated other comprehensive income to the Consolidated Statements of Income (Loss) for the three or nine months ended December 31, 2013 or 2012.

Recent Accounting Developments

In June 2013, the Financial Accounting Standards Board ("FASB") updated the guidance for investment company entities. The update clarifies the characteristics of an investment company, provides comprehensive guidance for assessing whether an entity is an investment company, requires an investment company to measure noncontrolling ownership interests in other investment companies at fair value rather than using the equity method, and requires additional disclosures. This update will be effective for Legg Mason in fiscal 2015. Legg Mason is evaluating its adoption.

In December 2013, the FASB ratified an Emerging Issues Task Force ("EITF") consensus that will update the guidance on measuring the financial assets and financial liabilities of consolidated collateralized financing entities. The update will require that an entity electing to apply the guidance should measure both the financial assets and financial liabilities using the fair value of the consolidated collateralized financing entity's financial assets or financial liabilities, whichever is more observable. This update will also require certain disclosures by entities that apply its provisions and will be effective for Legg Mason in fiscal 2016, unless adopted earlier. Legg Mason is evaluating its adoption.

3. Acquisition

On March 13, 2013, Permal, a wholly-owned subsidiary of Legg Mason, completed the acquisition of all of the outstanding share capital of Fauchier Partners Management, Limited ("Fauchier"), a European based manager of funds-of-hedge funds, from BNP Paribas Investment Partners, S.A. in accordance with a Sale and Purchase Agreement ("SPA") entered into in December 2012. This transaction expanded Permal's institutional business, creating a global institutional capability across geographies and client profiles. At the time of acquisition Fauchier managed assets of approximately $5,400,000.

The initial purchase price was a cash payment of $63,433, using the exchange rate between the British pound and U.S. dollar at the acquisition date, and was funded from existing cash resources. In addition, contingent consideration of up to approximately $25,000 and approximately $33,000 (using the exchange rate between the British pound and the U.S. dollar as of December 31, 2013) may be due on or about the second and fourth anniversaries of closing, respectively, dependent on achieving certain levels of revenue, net of distribution costs, and subject to a catch-up adjustment on the fourth anniversary of closing. The contingent consideration liability established at closing had an acquisition date fair value of $21,566, which represented the present value of the contingent consideration expected to be paid. As of December 31, 2013, the fair value of the contingent consideration liability was $28,877, an increase of $6,977 from March 31, 2013, with $5,000 attributable to revised estimates of amounts that will be payable and $1,977 attributable to changes in the exchange rate. The contingent consideration liability is included in Other liabilities in the Consolidated Balance Sheet. The increase in the contingent consideration liability due to revised estimates of amounts that will be payable was recorded in Other expenses in the Consolidated Statements of Income (Loss) for the three and nine months ended December 31, 2013. Legg Mason has executed currency forwards to economically hedge the risk of movements in the exchange rate between the U.S. dollar and the British pound in which the estimated contingent liability payment amounts are denominated. See Note 11 for additional information regarding derivatives and hedging.

A summary of the acquisition-date fair values of the assets acquired and liabilities assumed are as follows:

Cash	$8,156	
Receivables	12,174	
Amortizable asset management contracts	2,865	
Indefinite-life fund management contracts	65,126	
Goodwill	28,983	
Other current liabilities, net	(16,667	)
Contingent consideration	(21,566	)
Deferred tax liability	(15,638	)
Total net assets acquired	$63,433	

The fair value of the amortizable asset management contracts is being amortized over a period of six years. None of the acquired intangible assets or goodwill are deductible for U.K. tax purposes.

Management estimated the fair values of the indefinite-life fund management contracts based upon discounted cash flow analyses, and the contingent consideration expected to be paid based upon probability-weighted revenue projections, using unobservable market data inputs, which are Level 3 measurements. As is typical with the acquisition of a portion of a business from a larger financial services firm with other related operations, Legg Mason expected some initial contraction in the acquired business. The significant assumptions used in these analyses at acquisition included projected annual cash flows, revenues and discount rates, are summarized as follows:

	Projected Cash Flow Growth Rates	Discount Rate
Indefinite-life fund management contracts	(35)% to 11% (weighted-average: 6%)	16.0%
	Projected Revenue Growth Rates	
Contingent consideration	(16)% to 1% (weighted-average: (5)%)	2.0%

The revised contingent consideration estimate at December 31, 2013, considers the higher level of Fauchier performance fees to date and includes various scenarios with net revenue growth rates ranging from 0% to 8% (weighted-average 2%) and a discount rate of 2.7%.

The Company has not presented pro forma combined results of operations for this acquisition because the results of operations as reported in the accompanying Consolidated Statements of Income (Loss) would not have been materially different. The financial results of Fauchier included in Legg Mason's consolidated financial results for the three and nine months ended December 31, 2013, include revenues of $28,660 and $59,250, respectively. Fauchier operations have been integrated such that the related expenses are not readily identifiable.

4. Investments and 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 December 31, 2013			
	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	$393,186	$—	$—	$393,186
Time deposits and other	—	110,036	—	110,036
Total cash equivalents	393,186	110,036	—	503,222
Current investments:				
Trading investments relating to long-term incentive compensation plans[2]	109,231	—	—	109,231
Trading proprietary fund products and other investments[3]	227,107	74,117	193	301,417
Equity method investments relating to long-term incentive compensation plans, proprietary fund products and other investments[4][5]	12,387	13,712	—	26,099
Total current investments	348,725	87,829	193	436,747
Available-for-sale investment securities[6]	2,066	10,088	—	12,154
Investments in partnerships, LLCs and other[6]	—	2,693	26,094	28,787
Equity method investments in partnerships and LLCs[4][6]	—	—	65,545	65,545
Derivative assets:				
Currency and market hedges	6,026	—	—	6,026
Other investments[6]	—	—	88	88
Total	$750,003	$210,646	$91,920	$1,052,569
Liabilities:				
Contingent consideration liability[7]	$—	$—	$(28,877)	$(28,877)
Derivative liabilities:				
Currency and market hedges	(5,950)	—	—	(5,950)
Total	$(5,950)	$—	$(28,877)	$(34,827)

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	As of March 31, 2013			
	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	$485,776	$—	$—	$485,776
Time deposits and other	—	177,471	—	177,471
Total cash equivalents	485,776	177,471	—	663,247
Current investments:				
Trading investments relating to long-term incentive compensation plans[2]	86,583	—	—	86,583
Trading proprietary fund products and other investments[3]	158,846	69,064	246	228,156
Equity method investments relating to long-term incentive compensation plans, proprietary fund products and other investments[4][5]	12,600	43,741	—	56,341
Total current investments	258,029	112,805	246	371,080
Available-for-sale investment securities[6]	2,034	10,354	12	12,400
Investments in partnerships, LLCs and other[6]	761	2,620	27,762	31,143
Equity method investments in partnerships and LLCs[4][6]	1,518	924	66,338	68,780
Derivative assets:				
Currency and market hedges	1,939	—	—	1,939
Other investments[6]	—	—	99	99
Total	$750,057	$304,174	$94,457	$1,148,688
Liabilities:				
Contingent consideration liability[7]	$—	$—	$(21,900)	$(21,900)
Derivative liabilities:				
Currency and market hedges	(781)	—	—	(781)
Total	$(781)	$—	$(21,900)	$(22,681)

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

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

(3) Trading 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 December 31, 2013, and were invested approximately 49% and 51% in equity and debt securities, respectively, as of March 31, 2013.

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

(5) Includes investments under the equity method (which approximate fair value) relating to long-term incentive compensation plans of $13,712 and $43,741 as of December 31, 2013 and March 31, 2013, respectively, and proprietary fund products and other investments of $12,387 and $12,600 as of December 31, 2013 and March 31,

2013, 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.
(7) See Note 3.

Proprietary fund products include initial cash investments made by Legg Mason to fund new investment strategies and products. The primary purpose of these "seed capital investments" is to generate an investment performance track record in a product in order to attract third-party investors. Legg Mason had investments in proprietary fund products which totaled $379,513 and $304,713, as of December 31, 2013 and March 31, 2013, respectively, which are substantially comprised of investments in 45 funds and 39 funds as of December 31, 2013 and March 31, 2013, respectively, that are individually

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greater than $1,000 and together comprise over 90% of the seed capital investment total in each period. Legg Mason's initial investment in a new product typically represents 100% of the ownership in that product.

Investments in proprietary fund products are initially consolidated and the individual securities within the portfolio are accounted for as trading investments. Legg Mason consolidates these products as long as it holds a controlling financial interest in the product. Upon deconsolidation, which typically occurs after several years, Legg Mason accounts for its investments in proprietary fund products as equity method investments if its ownership is between 20% and 50%, or it otherwise has the ability to significantly influence the financial and operating policies of the investee. For partnerships and LLCs, where third-party investors may have less ability to influence operations, the equity method of accounting is considered if Legg Mason's ownership is greater than 3%. Changes in the fair value of proprietary fund products classified as trading or equity method investments are recognized in Other non-operating income (expense) on the Consolidated Statements of Income (Loss).

Legg Mason generally redeems its investment in proprietary fund products when the related product establishes a sufficient track record, when third-party investments in the related product are sufficient to sustain the strategy, or a decision is made to no longer pursue the strategy. The length of time Legg Mason holds a majority interest in a product varies based on a number of factors, such as market demand, market conditions and investment performance. See Note 12 for information regarding the determination of whether investments in proprietary fund products represent variable interest entities ("VIEs").

Substantially all of the above financial instruments where valuation methods rely on other than observable market inputs as a significant input utilize the equity method, the cost method, or NAV practical expedient discussed below, such that measurement uncertainty has little relevance.

The changes in financial assets and (liabilities) measured at fair value using significant unobservable inputs (Level 3) for the three and nine months ended December 31, 2013 and 2012, are presented in the tables below:

	Value as of September 30, 2013	Purchases	Sales	Redemptions/ Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of December 31, 2013
Assets:							
Trading proprietary fund products and other investments	$209	$1	$—	$(25)	$—	$8	$193
Investments in partnerships, LLCs and other	27,189	—	—	(883)	—	(212)	26,094
Equity method investments in partnerships and LLCs	63,639	1,598	—	(1,812)	—	2,120	65,545
Other investments	107	—	(12)	—	—	(7)	88
	$91,144	$1,599	$(12)	$(2,720)	$—	$1,909	$91,920
Liabilities:							
Contingent consideration liability	$(23,335)	$—	$—	$—	$—	$(5,542)	$(28,877)

	Value as of September 30, 2012	Purchases	Sales	Redemptions/ Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of December 31, 2012
Assets:							
Equity method investments in proprietary fund products	$11,705	$—	$—	$(11,705)	$—	$ —	$—
Investments in partnerships, LLCs and other	28,041	—	(182)	(46)	—	(349)	27,464
Equity method investments in partnerships and LLCs	129,294	911	(1,183)	(64,513)	—	(1,273)	63,236
Other investments	131	—	—	—	—	(12)	119
	$169,171	$911	$(1,365)	$(76,264)	$—	$ (1,634)	$90,819

	Value as of March 31, 2013	Purchases	Sales	Redemptions/ Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of December 31, 2013
Assets:							
Trading proprietary fund products and other investments	$246	$1	$—	$(69)	$—	$ 15	$193
Investments in partnerships, LLCs and other	27,762	800	(617)	(1,047)	—	(804)	26,094
Equity method investments in partnerships and LLCs	66,338	4,364	(750)	(7,500)	—	3,093	65,545
Other investments	111	—	(12)	—	—	(11)	88
	$94,457	$5,165	$(1,379)	$(8,616)	$—	$ 2,293	$91,920
Liabilities:							
Contingent consideration liability	$(21,900)	$—	$—	$—	$—	$ (6,977)	$(28,877)

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	Value as of March 31, 2012	Purchases	Sales	Redemptions/Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of December 31, 2012
Assets:							
Equity method investments in proprietary fund products	$11,778	$—	$—	$ (11,705)	$—	$ (73)	$—
Investments in partnerships, LLCs and other	28,763	—	(970)	(612)	—	283	27,464
Equity method investments in partnerships and LLCs	166,438	1,123	(2,025)	(116,579)	—	14,279	63,236
Other investments	124	—	—	—	—	(5)	119
	$207,103	$1,123	$(2,995)	$ (128,896)	$—	$ 14,484	$90,819

Realized and unrealized gains and losses recorded for Level 3 investments are primarily included in Other Non-Operating Income (Expense) on the Consolidated Statements of Income (Loss). The change in unrealized losses for Level 3 investments and liabilities still held at the reporting date was $156 and $1,632 for the three months ended December 31, 2013 and 2012, respectively. The change in unrealized losses for Level 3 investments and liabilities still held at the reporting date was $2,553 and $4,150 for the nine months ended December 31, 2013 and 2012, respectively. Also, included in realized and unrealized gains (losses), net, for the periods ended December 31, 2013, is the change in the fair value of the contingent consideration liability.

There were no significant transfers between Level 1 and Level 2 during the three months ended December 31, 2013 and 2012.

As a practical expedient, Legg Mason relies on the NAV of certain investments as their fair value. The NAVs that have been provided by the investees have been derived from the fair values of the underlying investments as of the respective reporting dates. The following table summarizes 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 December 31, 2013	
Category of Investment	Investment Strategy	December 31, 2013		March 31, 2013		Unfunded Commitments	Remaining Term
Funds-of-hedge funds	Global macro, fixed income, long/short equity, natural resources, systematic, emerging market, European hedge	$34,964	(1)	$38,811	(1)	n/a	n/a
Hedge funds	Fixed income - developed market, event driven, fixed income - hedge, relative value arbitrage, European hedge	21,188		24,716		$20,000	n/a
Private equity funds	Long/short equity	23,587	(2)	23,763	(2)	6,061	Up to 10 years
Other	Various	2,391		2,408		n/a	Various (3)
Total		$82,130	(4)	$89,698	(4)	$26,061	

n/a-not applicable

(1) 40% monthly redemption and 60% quarterly redemption as of December 31, 2013. 49% monthly redemption and 51% quarterly redemption as of March 31, 2013. Any remaining lock-up expired in June 2013.

(2) Liquidations are expected over the remaining term.

(3) Of this balance, 10% has a remaining term of less than one year and 90% has a remaining term of 20 years.

(4) Comprised of approximately 30% and 70% of Level 2 and Level 3 assets, respectively, as of December 31, 2013 and 32% and 68% of Level 2 and Level 3 assets, respectively, as of March 31, 2013.

There are no current plans to sell any of these investments held as of December 31, 2013.

5. Fixed Assets

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

	December 31, 2013	March 31, 2013
Equipment	$148,467	$152,065
Software	242,199	227,739
Leasehold improvements	213,665	222,260
Total cost	604,331	602,064
Less: accumulated depreciation and amortization	(412,286)	(400,245)
Fixed assets, net	$192,045	$201,819

Depreciation and amortization expense included in operating expenses was $12,802 and $12,822 for the three months ended December 31, 2013 and 2012, respectively, and $36,825 and $39,293 for the nine months ended December 31, 2013 and 2012, respectively.

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6. Intangible Assets and Goodwill

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

	December 31, 2013	March 31, 2013
Amortizable asset management contracts		
Cost	$207,037	$208,651
Accumulated amortization	(196,128)	(186,324)
Net	10,909	22,327
Indefinite–life intangible assets		
U.S. domestic mutual fund management contracts	2,106,351	2,106,351
Permal/Fauchier funds-of-hedge fund management contracts	692,133	692,133
Other fund management contracts	304,505	303,951
Trade names	52,800	52,800
	3,155,789	3,155,235
Intangible assets, net	$3,166,698	$3,177,562

Legg Mason completed its annual impairment testing process of goodwill and indefinite-life intangible assets and determined that there was no impairment in the value of these assets as of December 31, 2013. As a result of uncertainty regarding future market conditions and economic results, assessing the fair value of the reporting unit and intangible assets requires management to exercise significant judgment. The current assessed fair value of the indefinite-life domestic mutual funds contracts asset related to the Citigroup Asset Management acquisition exceeds the carrying value by 21%. The current assessed fair value of the indefinite-life funds-of-hedge funds contracts asset related to the Permal and Fauchier acquisitions exceeds the combined carrying values by 10%. Should market performance, flows, or related assets under management levels decrease in the near term such that cash flow projections deviate from current projections, it is reasonably possible that the assets could be deemed to be impaired by a material amount.

As part of Legg Mason's annual impairment testing process in the prior fiscal year, the Company concluded that the carrying value of two significant indefinite-life fund management contract intangible assets and a trade name asset exceeded their respective fair values, and the assets were impaired by an aggregate amount of $734,000. The impairment charges resulted from a number of then current trends and factors. These changes resulted in a reduction of the projected cash flows and Legg Mason's overall assessment of fair value of the assets, such that the fair value of the domestic mutual fund management contracts asset, Permal funds-of-hedge fund management contracts asset, and Permal trade name declined below their carrying values, and accordingly were impaired by $396,000, $321,000, and $17,000, respectively. Management estimated the fair values of the indefinite-life intangible assets based upon discounted cash flow analyses using unobservable market data inputs, which are Level 3 measurements. The significant assumptions used in these cash flow analyses as of December 31, 2012, included projected cash flows and discount rates, summarized as follows:

	Projected Cash Flow Growth Rates		
	Range	Average	Discount Rates
Domestic mutual fund contracts asset	3% to 9%	6%	14.5%
Permal funds-of-hedge funds contracts and trade name assets	(1)% to 17%	8%	16.0%

As of December 31, 2013, amortizable asset management contracts are being amortized over a weighted-average remaining life of 3.4 years.

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

Remaining 2014	$902
2015	3,405
2016	3,148
2017	2,484
2018	485
Thereafter	485
Total	$10,909

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

	Gross Book Value	Accumulated Impairment	Net Book Value
Balance as of March 31, 2013	$2,431,065	$(1,161,900)	$1,269,165
Impact of excess tax basis amortization	(16,179)	—	(16,179)
Other, including changes in foreign exchange rates	(12,251)	—	(12,251)
Balance as of December 31, 2013	$2,402,635	$(1,161,900)	$1,240,735

7. Long-Term Debt

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

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

	December 31, 2013			March 31, 2013
	Current Accreted Value	Unamortized Discount	Maturity Amount	Accreted Value
5.5% senior notes	$644,801	$5,199	$650,000	$644,077
Five-year amortizing term loan	450,000	—	450,000	500,000
Other term loans	438	—	438	877
Subtotal	1,095,239	5,199	1,100,438	1,144,954
Less: current portion	50,438	—	50,438	50,438
Total	$1,044,801	$5,199	$1,050,000	$1,094,516

As of December 31, 2013, the aggregate maturities of long-term debt, based on their contractual terms, are as follows:

Remaining 2014	$—
2015	50,438
2016	50,000
2017	50,000
2018	300,000
Thereafter	650,000
Total	$1,100,438

At December 31, 2013, the estimated fair value of long-term debt was approximately $1,168,207. The carrying value of the five-year term loan approximates fair value because the debt is a credit facility with a market-based variable interest rate. The fair value of the 5.5% senior notes was estimated using publicly quoted market prices and, along with the fair value of other long-term debt, was classified as Level 2 in the fair value hierarchy.

See Note 13 for subsequent issuance of $400,000 of 5.625% senior notes, repayment of the $450,000 of outstanding borrowings under the five-year term loan, and a $250,000 increase in the amount available under revolving credit facilities in January 2014.

8. Stock-Based Compensation

Legg Mason's stock-based compensation includes stock options, restricted stock awards and units, an employee stock purchase plan, deferred compensation payable in stock, and other stock-based compensation. Shares available for issuance under the active equity incentive stock plan as of December 31, 2013, were 9,802. 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.

Stock Options
Compensation expense relating to stock options for the three months ended December 31, 2013, and 2012 was $3,184 and $2,504, respectively, and for the nine months ended December 31, 2013 and 2012, was $10,171 and $8,407, respectively.

Stock option transactions during the nine months ended December 31, 2013 and 2012, respectively, are summarized below:

	Nine Months Ended December 31,					
	2013			2012		
	Number of Shares		Weighted-Average Exercise Price Per Share	Number of Shares		Weighted-Average Exercise Price Per Share
Options outstanding at March 31	5,361		$53.13	5,624		$57.78
Granted	1,215		33.64	966		23.72
Exercised	(628	)	30.34	(11	)	15.48
Canceled/forfeited	(952	)	98.51	(808	)	48.94
Options outstanding at December 31	4,996		$42.62	5,771		$53.39

At December 31, 2013, options were exercisable for 2,561 shares and the weighted-average exercise price was $53.87. Stock options exercisable at December 31, 2013, have a weighted-average remaining contractual life of 3.0 years. Unamortized compensation cost at December 31, 2013, was $20,427 and is related to unvested options for 2,435 shares. The unamortized compensation cost at December 31, 2013 is expected to be recognized over a weighted-average period of 1.6 years.

The weighted-average fair value of service-based stock option grants during the nine months ended December 31, 2013, and 2012, excluding those granted to our Chief Executive Officer in May 2013 discussed below, using the Black-Scholes option pricing model, was $12.13 and $9.47 per share, respectively.

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

	Nine Months Ended December 31,			
	2013		2012	
Expected dividend yield	1.54	%	1.44	%
Risk-free interest rate	0.80	%	0.81	%
Expected volatility	45.08	%	51.80	%
Expected life (in years)	4.93		5.02	

In May 2013, Legg Mason awarded options to purchase 500 shares of Legg Mason, Inc. common stock at an exercise price of $31.46, equal to the then current market value of Legg Mason's common stock, to its Chief Executive Officer, which is included in the outstanding options table. The award had a grant date fair value of $5,525 and is subject to vesting requirements, 25% of which vests over a two-year service period; 25% of which vests over a two-year service period and is subject to Legg Mason's common stock price equaling or exceeding $36.46 for 20 consecutive trading days; 25% of which is subject to Legg Mason's common stock price equaling or exceeding $41.46 for 20 consecutive trading days; and 25% of which is subject to

Legg Mason's common stock price equaling or exceeding $46.46 for 20 consecutive trading days; as well as a requirement that certain shares received upon exercise are retained for a two-year period.

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

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

Restricted Stock

Compensation expense relating to restricted stock and restricted stock units for the three months ended December 31, 2013 and 2012, was $12,013 and $10,730, respectively, and for the nine months ended December 31, 2013 and 2012, was $36,844 and $31,753, respectively.

Compensation expense for the nine months ended December 31, 2012, includes approximately $1,800 of accelerated stock-based net compensation costs associated with Legg Mason's former Chief Executive Officer stepping down in September 2012.

Restricted stock and restricted stock unit transactions during the nine months ended December 31, 2013 and 2012, respectively, are summarized below:

	Nine Months Ended December 31,					
	2013			2012		
	Number of Shares		Weighted-Average Grant Date Value	Number of Shares		Weighted-Average Grant Date Value
Unvested shares at March 31	3,738		$ 27.99	2,873		$ 33.83
Granted	1,289		35.16	2,185		24.04
Vested	(1,351	)	29.09	(935	)	32.12
Canceled/forfeited	(148	)	29.01	(143	)	58.59
Unvested shares at December 31	3,528		$ 30.15	3,980		$ 27.97

Unamortized compensation cost related to unvested restricted stock and restricted stock unit awards at December 31, 2013 was $71,334. The unamortized compensation expense as of December 31, 2013 is expected to be recognized over a weighted-average period of 1.7 years.

Other

Compensation expense relating to the stock purchase plan and deferred compensation payable in stock for the three months ended December 31, 2013 and 2012, was $80 and $89, respectively, and for the nine months ended December 31, 2013 and 2012, was $312 and $325, respectively.

On June 28, 2013, Legg Mason implemented a management equity plan and granted units to key employees of Permal that entitle them to participate in 15% of the future growth of the Permal enterprise value (subject to appropriate discounts), if any, subsequent to the grant date. An independent valuation determined the aggregate cost of the current award to be approximately $9,000, which will be recognized as Compensation expense in the Consolidated Statements of Income (Loss) over the related vest period, through December 2017. Compensation expense related to the Permal management equity plan was $908 and $1,816 for the three and nine months ended December 31, 2013, respectively.

During the nine months ended December 31, 2013 and 2012, non-employee directors were granted 11 and 17 restricted stock units and 47 and 35 shares of common stock at a fair value of $1,950 and $1,250, respectively. As of December 31, 2013 and 2012, non-employee directors held 35 and 112 stock options, respectively, which are included in the outstanding options table. As of December 31, 2013 and 2012, non-employee directors held 64 and 91 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 nine months ended December 31, 2013, there were 38 restricted stock units distributed and non-employee directors did not exercise any stock options. During the nine months ended December 31, 2012, there were no restricted stock units distributed and non-employee directors did not exercise any stock options. During the nine months ended December 31, 2013 and 2012, there were 77 and 72 stock options canceled or forfeited, respectively, related to non-employee directors.

9. Commitments and Contingencies

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

As of December 31, 2013, the minimum annual aggregate rentals under operating leases and service agreements are as follows:

Remaining 2014	$35,867
2015	127,204
2016	110,740
2017	95,958
2018	86,514
Thereafter	423,558
Total	$879,841

The minimum rental commitments shown above have not been reduced by $176,081 for minimum sublease rentals to be received in the future under non-cancelable subleases, of which approximately 40% is due from one counterparty. The lease reserve liability, included in the table below, for space subleased as of December 31, 2013 was $40,362. If a sub-tenant defaults on a sublease, Legg Mason may incur operating charges to adjust the existing lease reserve liability to reflect expected future sublease rentals at reduced amounts, as a result of the current commercial real estate market.

The above minimum rental commitments include $806,509 in real estate and equipment leases and $73,332 in service and maintenance agreements.

The minimum rental commitments shown above also have not been reduced by $23,638 for commitments related to space that has been vacated, but for which subleases are being pursued. The lease reserve liability, also included in the table below, for vacant space for which subleases are being pursued was $13,811 as of December 31, 2013, and remains subject to adjustment based on circumstances in the real estate markets that may require a change in assumptions or the actual terms of a sublease that is ultimately secured. The lease reserve liability takes into consideration various assumptions, including the expected amount of time it will take to secure a sublease agreement and prevailing rental rates in the applicable real estate markets.

The table below presents a summary of the changes in the lease reserve liability for subleased space and vacated space for which subleases are being pursued:

Balance as of March 31, 2012	$44,763	
Accrued charges for vacated and subleased space	39,080	
Payments, net	(15,341	)
Adjustments and other	(1,590	)
Balance as of March 31, 2013	66,912	
Accrued charges for vacated and subleased space	3,529	
Payments, net	(14,048	)

Adjustments and other	(2,220)
Balance as of December 31, 2013	$54,173

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As of December 31, 2013, Legg Mason had commitments to invest approximately $35,367 in limited partnerships that make private investments. These commitments are expected to be funded as required through the end of the respective investment periods continuing through fiscal 2021.

In connection with the acquisition of Fauchier, as further discussed in Note 3, contingent consideration of up to approximately $25,000 and approximately $33,000 (using the exchange rate between the British pound and U.S. dollar as of December 31, 2013), may be due on or about the second and fourth anniversaries of closing, respectively, which is dependent upon achieving certain levels of revenue, net of distribution costs, and subject to a catch up adjustment on the fourth anniversary. The fair value of the contingent consideration liability was $28,877 as of December 31, 2013, an increase of $6,977 from March 31, 2013, with $5,000 attributable to revised estimates of amounts payable and $1,977 attributable to changes in the exchange rate. Legg Mason has executed currency forwards to economically hedge the risk of movements in the exchange rate between the U.S. dollar and the British pound in which the estimated contingent liability payment amounts are denominated. See Note 11 for additional information regarding derivatives and hedging.

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

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

In a transaction with Citigroup in December 2005, Legg Mason transferred to Citigroup the subsidiaries that constituted its Private Client/Capital Markets ("PC/CM") businesses, thus transferring the entities that would have primary liability for most of the customer complaint, litigation and regulatory liabilities and proceedings arising from those businesses. However, as part of that transaction, Legg Mason agreed to indemnify Citigroup for most customer complaint, litigation and regulatory liabilities of Legg Mason's former PC/CM businesses that result from pre-closing events. While the ultimate resolution of these matters cannot be determined based on current information, after consultation with legal counsel, management believes that any accrual or range of reasonably possible losses as of December 31, 2013, 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 Citigroup Asset Management ("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. Legg Mason agreed to settle this matter in December 2013. The settlement did not have a material effect on Legg Mason's financial position, results of operations or cash flows.

Additionally, there were two matters subject to regulatory investigations involving one of Legg Mason's asset management subsidiaries regarding its compliance with applicable legal requirements with respect to investments made for certain client accounts. These matters have been settled with the regulators. The settlements did not have a material effect on Legg Mason's financial position, results of operations or cash flows.

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

In management's opinion, an adequate accrual has been made as of December 31, 2013, to provide for any probable losses that may arise from matters for which the Company could reasonably estimate an amount. Legg Mason's financial condition, results of operations and cash flows could be materially affected during a period in which a matter is ultimately resolved. In addition, the ultimate costs of litigation-related charges can vary significantly from period-to-period, depending on factors such as market conditions, the size and volume of customer complaints and claims, including class action suits, and recoveries from indemnification, contribution, insurance reimbursement, or reductions in compensation under revenue share arrangements.

10. Earnings Per Share

Basic EPS is calculated by dividing Net Income (Loss) Attributable to Legg Mason, Inc. by the weighted-average number of shares outstanding. The calculation of weighted-average shares includes common shares, shares exchangeable into common stock 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. For periods where a net loss attributable to Legg Mason, Inc. is reported, the inclusion of potentially issuable common shares will decrease the net loss per share. Since this would be antidilutive, such shares are excluded from the calculation.

During the three and nine months ended December 31, 2013, Legg Mason purchased and retired 2,319 and 7,636 shares, respectively, of its common stock for $90,000 and $269,996, respectively, through open market purchases under the current share repurchase authorization. These repurchases reduced weighted-average shares outstanding by 6,457 and 3,788 shares for the three and nine months ended December 31, 2013, respectively.

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

	Three Months Ended December 31,			
	2013		2012	
	Basic	Diluted	Basic	Diluted [1]
Weighted-average basic shares outstanding	120,583	120,583	131,534	131,534
Potential common shares:				
Employee stock options	—	543	—	—
Weighted-average diluted shares	120,583	121,126	131,534	131,534
Net Income (Loss)	$79,951	$79,951	$(458,550)	$(458,550)
Less: Net loss attributable to noncontrolling interests	(1,783)	(1,783)	(4,680)	(4,680)
Net Income (Loss) Attributable to Legg Mason, Inc.	$81,734	$81,734	$(453,870)	$(453,870)
Net Income (Loss) per share Attributable to Legg Mason, Inc. Common Shareholders	$0.68	$0.67	$(3.45)	$(3.45)

	Nine Months Ended December 31,			
	2013		2012	
	Basic	Diluted	Basic	Diluted (1)
Weighted-average basic shares outstanding	122,920	122,920	134,770	134,770
Potential common shares:				
Employee stock options	—	316	—	—
Weighted-average diluted shares	122,920	123,236	134,770	134,770
Net Income (Loss)	$216,744	$216,744	$(390,439)	$(390,439)
Less: Net income (loss) attributable to noncontrolling interests	907	907	(7,908)	(7,908)
Net Income (Loss) Attributable to Legg Mason, Inc.	$215,837	$215,837	$(382,531)	$(382,531)
Net Income (Loss) per Share Attributable to Legg Mason, Inc. Common Shareholders	$1.76	$1.75	$(2.84)	$(2.84)

(1) Diluted shares are the same as basic shares for periods with a net loss.

The diluted EPS calculations for the three and nine months ended December 31, 2013 and 2012, exclude any potential common shares issuable under the 14,205 warrants issued in connection with the repurchase of Legg Mason's outstanding 2.5% Convertible Senior Notes because the market price of Legg Mason common stock did not exceed the exercise price, and therefore the warrants would be deemed antidilutive.

Options to purchase 2,314 and 2,932 shares for the three and nine months ended December 31, 2013, respectively, were not included in the computation of diluted EPS because the presumed proceeds from exercising such options, including the related income tax benefits, exceeded the average price of the common shares for the period and therefore the options are deemed antidilutive. Further, market-based options are excluded from potential dilution until the designated market condition is met. The diluted EPS calculation for the three and nine months ended December 31, 2012, excludes 5,733 and 5,863 potential common shares, respectively, that are antidilutive due to the net loss in each period.

11. Derivatives and Hedging

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

Legg Mason uses currency forwards to economically hedge the risk of movements in exchange rates, primarily between the U.S. dollar, British pound, Japanese yen, Australian dollar, euro, Singapore dollar, Chinese yuan, Indian rupee, Malaysian ringgit, Philippine peso, Thai baht and South Korean won. In the Consolidated Balance Sheets, Legg Mason nets the fair value of certain foreign currency forwards or futures contracts executed with the same counterparty where Legg Mason has both the legal right and intent to settle the contracts on a net basis, resulting in net Other assets of $76 and $1,158 as of December 31, 2013 and March 31, 2013, respectively. Legg Mason has not designated any derivatives as hedging instruments for accounting purposes during the periods ended December 31, 2013, March 31, 2013 and December 31, 2012.

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 $13,365 and $7,131 as of December 31, 2013 and March 31, 2013, respectively.

The following table presents the gross fair values as of December 31, 2013 and March 31, 2013, of derivative instruments not designated as hedging instruments for accounting purposes:

	December 31, 2013		March 31, 2013	
	Assets	Liabilities	Assets	Liabilities
Currency forward contracts	$5,987	$2,240	$1,496	$101
Futures contracts	39	3,710	443	680
Total	$6,026	$5,950	$1,939	$781

The following table presents gains (losses) recognized on derivative instruments not designated as hedging instruments for accounting purposes:

		Three Months Ended December 31,			
		2013		2012	
	Income Statement Classification	Gains	Losses	Gains	Losses
Currency forward contracts for:					
Operating activities	Other expense	$2,011	$(1,416)	$1,016	$(1,250)
Seed capital investments	Other non-operating income (expense)	481	(863)	39	(401)
Futures contracts	Other non-operating income (expense)	79	(7,553)	78	(986)
Total		$2,571	$(9,832)	$1,133	$(2,637)

		Nine Months Ended December 31,			
		2013		2012	
	Income Statement Classification	Gains	Losses	Gains	Losses
Currency forward contracts for:					
Operating activities	Other expense	$6,222	$(3,417)	$1,543	$(1,564)
Seed capital investments	Other non-operating income (expense)	989	(2,063)	98	(453)
Futures contracts	Other non-operating income (expense)	959	(16,636)	1,230	(2,584)
Total		$8,170	$(22,116)	$2,871	$(4,601)

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. 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. Certain of these investment vehicles are considered to be VIEs (further described below) while others are considered to be voting rights entities (“VREs”) subject to traditional consolidation concepts based on ownership rights. Investment vehicles that are considered VREs are consolidated if Legg Mason has a controlling financial interest in the investment vehicle, absent substantive kick-out rights. Legg Mason held a controlling financial interest in one sponsored investment fund VRE with third-party investments which was consolidated as of December 31, 2013, March 31, 2013 and December 31, 2012.

Investment Company VIEs

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

Legg Mason concluded it was the primary beneficiary of one sponsored investment fund VIE, which was consolidated in each period covered by this report, December 31, 2013, March 31, 2013 and December 31, 2012, despite significant third-party investments in this product.

Other VIEs
For other sponsored investment funds that do not meet the investment company 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 December 31, 2013, March 31, 2013 and December 31, 2012, the balances related to this CLO were consolidated on the Company's consolidated financial statements. The other CLO is not consolidated, as its level of expected subordinated fees is insignificant.

Legg Mason's investment in CIVs as of December 31, 2013 and March 31, 2013, was $42,497 and $39,056, 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 December 31, 2013 and March 31, 2013, respectively, and the Consolidated Statements of Income (Loss) for the three and nine months ended December 31, 2013 and 2012, respectively:

Consolidating Balance Sheets

	December 31, 2013				March 31, 2013			
	Balance Before Consolidation of CIVs	CIVs	Eliminations	Consolidated Totals	Balance Before Consolidation of CIVs	CIVs	Eliminations	Consolidated Totals
Current Assets	$1,886,674	$41,404	$(42,815)	$1,885,263	$1,908,932	$73,320	$(39,390)	$1,942,862
Non-current assets	4,999,914	120,450	—	5,120,364	5,115,181	211,617	—	5,326,798
Total Assets	$6,886,588	$161,854	$(42,815)	$7,005,627	$7,024,113	$284,937	$(39,390)	$7,269,660
Current Liabilities	$728,873	$923	$(318)	$729,478	$692,261	$10,539	$(334)	$702,466
Long-term debt of CIVs	—	94,370	—	94,370	—	207,835	—	207,835
Other non-current liabilities	1,411,971	2,046	—	1,414,017	1,517,069	2,930	—	1,519,999
Total Liabilities	2,140,844	97,339	(318)	2,237,865	2,209,330	221,304	(334)	2,430,300
Redeemable Non-controlling Interests	3,191	—	17,867	21,058	1,355	—	19,654	21,009
Total Stockholders' Equity	4,742,553	64,515	(60,364)	4,746,704	4,813,428	63,633	(58,710)	4,818,351
Total Liabilities and Stockholders'	$6,886,588	$161,854	$(42,815)	$7,005,627	$7,024,113	$284,937	$(39,390)	$7,269,660

Equity

Consolidating Statements of Income (Loss)

	Three Months Ended December 31, 2013 Balance Before Consolidation of CIVs	CIVs	Eliminations	Consolidated Totals	December 31, 2012 Balance Before Consolidation of CIVs	CIVs	Eliminations	Consolidated Totals
Total Operating Revenues	$720,591	$—	$(499)	$720,092	$674,506	$—	$(606)	$673,900
Total Operating Expenses	598,299	641	(500)	598,440	1,307,124	703	(604)	1,307,223
Operating Income (Loss)	122,292	(641)	1	121,652	(632,618)	(703)	(2)	(633,323)
Total other non-operating income (expense)	5,496	690	(1,883)	4,303	(1,385)	(3,458)	(598)	(5,441)
Income (Loss) Before Income Tax Provision (Benefit)	127,788	49	(1,882)	125,955	(634,003)	(4,161)	(600)	(638,764)
Income tax provision (benefit)	46,004	—	—	46,004	(180,214)	—	—	(180,214)
Net Income (Loss)	81,784	49	(1,882)	79,951	(453,789)	(4,161)	(600)	(458,550)
Less: Net income (loss) attributable to noncontrolling interests	50	—	(1,833)	(1,783)	81	—	(4,761)	(4,680)
Net Income (Loss) Attributable to Legg Mason, Inc.	$81,734	$49	$(49)	$81,734	$(453,870)	$(4,161)	$4,161	$(453,870)

	Nine Months Ended December 31, 2013 Balance Before Consolidation of CIVs	CIVs	Eliminations	Consolidated Totals	December 31, 2012 Balance Before Consolidation of CIVs	CIVs	Eliminations	Consolidated Totals
Total Operating Revenues	$2,061,998	$—	$(1,637)	$2,060,361	$1,946,667	$—	$(1,780)	$1,944,887
Total Operating Expenses	1,748,486	1,960	(1,637)	1,748,809	2,421,982	2,196	(1,779)	2,422,399
Operating Income (Loss)	313,512	(1,960)	—	311,552	(475,315)	(2,196)	(1)	(477,512)
	(6,505)	5,676	(3,030)	(3,859)	(75,651)	(6,089)	(1)	(81,741)

Total other non-operating income (expense)								
Income (Loss) Before Income Tax Provision (Benefit)	307,007	3,716	(3,030)	307,693	(550,966)	(8,285)	(2)	(559,253)
Income tax provision (benefit)	90,949	—	—	90,949	(168,814)	—	—	(168,814)
Net Income (Loss)	216,058	3,716	(3,030)	216,744	(382,152)	(8,285)	(2)	(390,439)
Less: Net income (loss) attributable to noncontrolling interests	221	—	686	907				