



Our vision is to be a proven leader in global asset management, by delivering specialized investment solutions that meet our clients' objectives, and by rewarding our shareholders and employees.



Front cover: Investment professionals, Legg Mason Global Asset Allocation and Legg Mason Investment Counsel

Pictured above: Western Asset investment strategy meeting



At Legg Mason, we share a common vision and a set of core values—guiding principles that define who we are and how we approach our business. A shared passion for results. Empowerment. A commitment to our profession. Collaboration. Integrity in all aspects of our business. These values are grounded in our proud heritage and reflect not only long held beliefs of Legg Mason, but also the unique cultures of our affiliates. They define how we do business day in and day out, year after year. This vision and these values—that's what motivates us as we deliver our **Investment {Driven}** expertise to clients around the world.






The foundation of our core values is a **passion for results**. We are relentless in pursuing performance that benefits our clients, rewards our employees and builds value for our shareholders.

We are enthusiastic about our business and are united by a passion for results and a spirit of determination. We strive to deliver strong investment results through customized solutions with an unwavering focus on the client. With an emphasis on service excellence, we commit to the continuous improvement of our global distribution capabilities and corporate center. We also recognize our responsibility to be active participants in our local communities and the value that comes from being a responsible corporate citizen.

Investment professionals, Royce & Associates







We have a culture that embraces innovation and empowerment —to drive new ideas, new products and new investment opportunities. That’s what drives our growth.

We believe that fostering a culture that embraces ownership and personal responsibility creates an environment in which people can be their best. We embrace an entrepreneurial spirit rooted in a clear and shared understanding of our underlying goals and empower our employees to move our business forward through greater innovation and new ideas and opportunities.


Investment and sales professionals, Permal





We are **committed to our profession**—to advancing our knowledge of investment management through continuous learning. And to leading the industry forward.

We encourage our employees to pursue continuous investment management learning and embrace curiosity and the discovery of new information. We take pride in our work and constantly strive to develop, adapt and improve ourselves through collaboration and the sharing of ideas. Every day, we are committed to fostering innovation and leading the industry forward.



We value **collaboration** and partnership within and across our multi-manager business, and foster a diverse, supportive environment.

We promote inclusion and participation in a team-focused environment. We seek and listen to diverse inputs and respectfully challenge one another in order to attain the best overall outcomes. We seek to leverage the capabilities of our affiliates, global distribution network and corporate center by engaging in the process of strategic decision-making. Importantly, we recognize that success often requires setting aside personal views or desires for the greater good of the company and that through collaboration, we are able to achieve creative solutions.

Investment and compliance professionals,  
ClearBridge and Legg Mason





Our company was founded on certain fundamental values. We operate from a position of **integrity**—and with a “no chalk” principle. That means doing the right thing for our clients and each other.

Our dedication to integrity and “no chalk” standard is a foundation of our past, current and future success. Like an athlete competing on a playing field, our employees are expected to stay well within the boundary lines of ethical behavior so that we never have “chalk on our shoes.” We believe that sound corporate governance is essential and we are committed to holding ourselves to high standards of conduct, including honesty and fairness in all aspects of our work.



Mark R. Fetting  
Chairman and Chief Executive Officer  
Legg Mason, Inc.

**Dear Fellow Stockholders:** I am pleased to report that we made marked progress in repositioning Legg Mason for future growth this past fiscal year.

Legg Mason delivered strong results year over year, with increases in revenues, net income, and operating margin. Additionally, we experienced notable improvements in investment performance, significantly reduced our rate of long-term outflows and repurchased 9% of shares outstanding since our prior fiscal year ended March 31, 2010. When I wrote to you last year, we had recently announced our streamlined business model to significantly reduce our cost structure and drive margin improvement and profitability. Our streamlining efforts are well underway and we enter fiscal 2012 with confidence that, as projected, we will deliver between \$130 and \$150 million in run rate cost savings to our shareholders by March 31, 2012.

The U.S. and most major global stock markets continued their rebound over the last year, with the

U.S. stock market rising to its highest level since the middle of 2008 on improved earnings in the corporate sector and rising investor confidence. We see clear signs of stability and growth returning to the global economy while continued fallout from European sovereign debt exposures, geopolitical risks, particularly in the Middle East, and concerns about financial regulation continue to weigh on the markets. As the Federal Reserve ends its bond repurchase program in the U.S. this month, it will be important for the private sector to begin investing and hiring in earnest to support the jobs and housing recoveries that have weighed on our economy. While we believe that the global economic recovery should pick up during the remainder of 2011, more recent trends are indicating that any recovery will remain gradual.



# Financial Highlights

(dollars in thousands, except per share amounts)

Years Ended March 31,	2011	2010	2009	2008	2007
<b>OPERATING RESULTS</b>					
Operating revenues	\$2,784,317	\$2,634,879	\$ 3,357,367	\$ 4,634,086	\$4,343,675
Operating income (loss)	386,808	321,183	(669,180)	1,050,176	1,028,298
Income (loss) from continuing operations before income tax provision (benefit) and noncontrolling interest	365,197	329,656	(3,188,197)	437,327	1,043,854
Net income (loss) attributable to Legg Mason, Inc. <sup>1</sup>	253,923	204,357	(1,967,918)	263,565	646,818
<b>PER COMMON SHARE</b>					
Diluted income <sup>1</sup>	\$ 1.63	\$ 1.32	\$ (13.99)	\$ 1.83	\$ 4.48
Adjusted income (loss) per diluted share <sup>2</sup>	2.83	2.45	(8.47)	6.11	5.86
Dividends declared	0.20	0.12	0.96	0.96	0.81
Book Value	38.41	35.94	31.87	48.15	45.99
<b>FINANCIAL CONDITION</b>					
Total assets	\$8,707,756	\$8,622,632	\$ 9,232,299	\$11,830,352	\$9,604,488
Total stockholders' equity	5,770,384	5,841,724	4,598,625	6,784,641	6,541,490

## Fiscal Year Results and Highlights

As of March 31, 2011, Legg Mason's assets under management were \$677.6 billion, a decrease of 1% from \$684.5 billion as of March 31, 2010. For the fiscal year ended March 31, 2011, we recorded operating revenues of \$2.8 billion, up 6% from \$2.6 billion in fiscal 2010. Net income increased 24% to \$253.9 million, or \$1.63 per diluted share for the same period, compared to \$204.4 million, or \$1.32 per diluted share for the prior year. Our adjusted income<sup>2</sup> was \$439.2 million, or \$2.83 per diluted share for fiscal year 2011, compared to \$381.3 million, or \$2.45 per diluted share for the prior year. The total return on Legg Mason's shares was 26.6% versus 17.0% for the SNL Asset Manager Index for the fiscal year ended March 31, 2011.

Our operating margin, as adjusted<sup>2</sup>, increased to 23.2% for the twelve months ending March 31, 2011, versus 20.7% for the same period a year ago. Importantly, our advisory fee yield ended the fiscal year at 36 basis points, up from 33 basis points a year ago, reflective of a higher percentage of assets in equities and alternatives and our success in attracting higher fee-yielding mandates, particularly in specialized fixed income mandates.

## Our Strategic Priorities and Progress

These results reflect clear progress and improvements in our business and refined multi-manager strategy. As we continue to deliver value and solidify our position as a leading global asset manager, we are guided by three strategic drivers of growth that we believe will most effectively position our franchise:

- First and foremost, delivering sustained investment excellence over the long term. Each of our independent investment managers strives to deliver investment excellence, while meeting their clients' objectives through continuous innovation and risk management, and creating superb franchise businesses of their own.
- Second, a corporate center that adds strategic value including excellence in global retail distribution focused on leveraging the unique capabilities of our investment affiliates and market opportunities where we have distribution relationships, across key channels, markets and products.
- And third, achieving a growth-oriented portfolio of affiliates. We seek to invest in strategic growth areas to enhance our products and distribution through lift-outs and bolt-ons or acquisition

<sup>1</sup> Fiscal 2009 includes losses related to the elimination of exposure to Structured Investment Vehicles, net of income tax benefits and compensation related adjustments, of \$1,376,579 or \$9.79 per share and impairment charges related to goodwill and intangible assets, net of income tax benefits, of \$863,352 or \$6.14 per share.

<sup>2</sup> Adjusted income, adjusted income (loss) per diluted share and operating margin, as adjusted represent performance measures that are based on a methodology other than generally accepted accounting principles ("non-GAAP"). For more information regarding these non-GAAP financial measures, see Management's Discussion and Analysis of Financial Condition and Results of Operations included in this Annual Report and the corporate website at [www.leggmason.com](http://www.leggmason.com) under the "Investor Relations—Annual Reports" section.



In February 2011, Western Asset celebrated the one year anniversary of the launch of the Western Asset Mortgage Defined Opportunity Fund (NYSE: DMO). During calendar year 2010, Legg Mason was the number one issuer of closed-end funds with \$1.9 billion in assets raised, according to the Closed-End Fund Association and SEC filings.

opportunities. As we focus on ways to drive growth, we remain committed to maintaining a strong balance sheet and returning capital to our shareholders, as appropriate.

In December 2010, we completed the realignment of our senior management team which includes Ron Dewhurst, Head of Global Investment Managers, Tom Lemke, General Counsel, Pete Nachtwey, Chief Financial Officer, Jeff Nattans, Head of M&A and Business Development, and Joe Sullivan, Head of Global Distribution. I believe that this proven and experienced team best positions us as we take advantage of opportunities in 2011 and beyond. Importantly, we are committed to the continuous improvement of our corporate center and a key element of our strategic priorities is to remain disciplined in monitoring our corporate efficiency and effectiveness.

#### Our Affiliates and Distribution Platform at Work

We remain highly encouraged by the improving trends in long-term flows, reflecting continued improved investment performance. The percentage of our long-term U.S. mutual fund assets outperforming their Lipper category average was 56% for the 1-year, 74% for the 3-year, 70% for the 5-year and 67% for the 10-year periods ending March 31, 2011. Investment performance, particularly at Western Asset, our largest affiliate, improved meaningfully during the fiscal year. Over 75% of Western Asset's marketed composite assets and over 70% of our firmwide marketed composite assets, including liquidity, outperformed their respective benchmarks for the 1-, 3-, 5-, and 10-year periods through March 2011. Additionally, Permal, Royce & Associates, and Brandywine Global experienced continued strong long-term performance.

Legg Mason raised a total of \$4.1 billion in new product launches during the fiscal year which helped drive a 43% reduction in long-term net outflows. We experienced positive flows in alternative assets during each quarter this fiscal year. Our equity outflows declined by 47% from the prior fiscal year and our fixed income outflows declined by 42% for the same period, but we know that we must do better. Our affiliates must now work to maintain their improved investment results and improve in areas in which they are underperforming.

Our Americas and International retail distribution platform is now centralized under the global leadership of Joe Sullivan. Gross sales generated by our Americas distribution group increased by 7% to \$36 billion during fiscal year 2011. In our International business, we continue to build momentum across our key markets and product areas, with gross sales up 74% and net flows up 140% from the prior fiscal year. Our International distribution group has posted nine consecutive quarters of long-term net inflows through March 2011. With meaningful sales improvements in both Americas and International, we are focusing on better positioning our teams to capture the unique capabilities of our affiliates, our extensive intermediary relationships, and an integrated approach to product development. We remain hard at work and, importantly, believe that the infrastructure we have in place is capable of supporting substantially greater distribution volume.



Legg Mason Japan hosted a seminar in Tokyo for fund distributors and local asset management companies in September 2010 and in collaboration with the Brazilian National Treasury. Additionally, Legg Mason Japan received an award for "Best Sales, Client Service and Marketing Support for fiscal year 2010—Special Award" from *Ma-Do*, an industry publication focused on the marketing and retail distribution of mutual funds in Japan.





David Hoffman



Steve Smith

Brandywine Global was named Bond Manager of the Year for 2010 by *Money Management Letter* for its global fixed income strategies as part of the 10th annual Public Pension Fund Awards for Excellence. The firm's global fixed income team is led by portfolio managers David Hoffman and Steve Smith.

Among the individual accolades received and achievements by our firm during the year are the following:

- Western Asset was named “KIC Best Long-Term Manager 2010” by the Korea Investment Corporation (KIC) in its inaugural KIC External Fund Manager Award. Western Asset was chosen by the sovereign wealth fund for its “exceptional performance, consistency and dedicated client service over a three-year period”;
- A Permal diversified multi-manager fixed income fund won *InvestHedge's* 10-year performance award for funds with assets greater than \$1 billion for the period ended December 31, 2010. Funds managed by Permal were also shortlisted in five *InvestHedge* award categories;
- Brandywine Global was named Bond Manager of the Year for 2010 by *Money Management Letter* for its global fixed income strategies;
- Three Royce & Associates funds and three Western Asset funds received 2011 Lipper Awards based on consistently strong risk-adjusted performance relative to their peers;
- In the annual *Barron's* ranking of best mutual fund families, Legg Mason ranked #8 out of 57 overall, #4 in the mixed equity category and #2 in the taxable bond category for the one-year ending December 31, 2010;
- Legg Mason was the number one issuer of closed-end funds for 2010 with \$1.9 billion in assets raised, a 22% market share<sup>3</sup>; and
  - Legg Mason and ClearBridge Advisors raised \$1.3 billion for the ClearBridge Energy MLP Fund Inc.
  - Legg Mason launched the Western Asset High Yield Defined Opportunity Closed-End Fund, with a total raise of \$444 million—the second highest raise to date for Legg Mason.

<sup>3</sup> Source: Closed-End Fund Association and SEC filings.

- Legg Mason Japan received an award for “Best Sales, Client Service and Marketing Support for fiscal year 2010—Special Award” from *Ma-Do*, an industry publication focused on the marketing and retail distribution of mutual funds in Japan.

### Balance Sheet Strength and Flexibility

From a balance sheet perspective, we continue to execute our capital management strategy outlined at the beginning of last year. During fiscal year 2011, we repurchased 9% or 14.6 million of shares outstanding at March 31, 2010, while maintaining a strong balance sheet with stable and continued cash generation. We ended the fiscal year with \$1.4 billion in cash and approximately \$1 billion in available cash. We recently announced a 33% increase in our quarterly cash dividend to \$0.08, which is now double the level of a year ago and we expect to repurchase up to \$400 million in shares during this fiscal year, subject to market conditions. We will continue to take a conservative approach to capital management, with a strategic desire to maintain flexibility to invest in top line growth opportunities.

### Positioning Ourselves for Growth

Having solidified our strategic growth objectives and demonstrated good progress during fiscal 2011, we are focused in fiscal 2012 on positioning ourselves for future growth across asset classes, geographies, channels, and products.



Permal, led by Isaac Souede, is one of the world's largest and oldest fund-of-hedge-fund managers, providing investment opportunities in directional and absolute return strategies across global financial markets. The company was recently profiled in *InvestHedge* for its specialized services and product innovation.



Hersh Cohen



Bill Miller



Chuck Royce



Steve Walsh

Earlier this year, our global distribution team hosted an exclusive webcast for over 675 clients with the theme “Striking the Right Balance.” The webcast featured the chief investment officers from four of our key affiliates who shared their market perspectives and insights: ClearBridge Advisors, Legg Mason Capital Management, Royce & Associates and Western Asset.

We intend to co-invest in our affiliates in organic growth; our seed capital balance as of March 31, 2011 stands at nearly \$430 million with \$100 million of seed capital invested for future growth during this fiscal year. We currently have in development additional closed-end fund launches across multiple affiliates including an energy master limited partnership fund that, subject to regulatory approvals, we believe will likely launch in the June 2011 quarter. Longer-term initiatives include further developing a pipeline of product ideas in the fixed income, equity and alternative asset classes. Our dedicated distribution team is also gaining momentum towards diversifying our distribution partners and channels, adding to our growth expectations.

An important element of our business model is the addition of investment capabilities through lift-out and bolt-on or acquisition opportunities. To date, we have made additions to our investment teams at several affiliates and anticipate these types of additive transactions to continue. We are committed to achieving a growth-oriented portfolio of quality affiliates, with an emphasis on bottom line earnings, and with products and in markets where we see the strongest long-term growth opportunities.

Our priorities in fiscal year 2012 are clear: supporting our affiliates in delivering on our fundamental goal of sustained investment excellence; completing our streamlining on time and realizing the projected cost savings; and exploiting growth opportunities for our managers through our global distribution platform, while deploying capital smartly for our shareholders.

**Appreciation and Closing**

In 2010, we were saddened by the loss of two inspirational leaders who made significant

contributions to our firm: Ernest Kiehne and Kenneth Battye. Ernie joined Legg & Co, a predecessor to Legg Mason, as director of research in 1967 and went on to become a founding manager of Legg Mason’s first equity mutual fund. He worked for Legg Mason until his passing and will be most remembered for his eternal optimism. Ken joined Legg & Co. in 1947, beginning a career with our firm that spanned 55 years, during which his compassion and commitment were unwavering. The contributions of both gentlemen left an indelible mark on Legg Mason and continue to guide us in the pursuit of our vision and values.

As Legg Mason continues to evolve and build upon its leading position in global asset management, our focus on the long term remains the same. We enter our new fiscal year energized and encouraged by the progress we have made and our opportunity to capture market share. Our firm has undergone many changes over the last three years that have affected our staff personally, but the constant that remains is their dedication and commitment to getting the job done. The road ahead will undoubtedly bring a new set of challenges as the global economy continues on its path towards recovery, but we believe in our ability to create value over the long term. And all of us at Legg Mason remain determined to further improve our results to clients and shareholders and grow our global franchise.

Mark R. Fetting  
Chairman and Chief Executive Officer  
June 8, 2011





Legg Mason unites some of the industry's leading asset managers under a single banner. With 485 investment professionals and recognized local, regional and global portfolio management expertise, we leverage our dedicated global distribution teams to deliver investment solutions to our clients on the ground, around the world. As of March 2011, Legg Mason managed over \$234 billion or 35% in assets from clients domiciled outside of the United States.

**Our Global Office Locations:**

**Bartlett & Co.**  
Cincinnati

**Batterymarch Financial Management**  
Boston

**Brandywine Global Investment Management**  
Philadelphia, London, San Francisco, Singapore

**ClearBridge Advisors**  
New York, San Francisco, Wilmington

**Legg Mason Capital Management**  
Baltimore

**Legg Mason Global Equities Group**  
Hong Kong, London, Melbourne, New York, Warsaw

**Legg Mason Investment Counsel & Trust**  
Baltimore, Cincinnati, Easton, New York, Philadelphia

**Legg Mason Global Asset Allocation**  
New York, Stamford

**Legg Mason Global Distribution**  
Baltimore, Frankfurt, Hong Kong, Kitchener, London, Luxembourg, Madrid, Melbourne, Miami, Milan, Montreal, New York, Paris, Santiago, Singapore, Stamford, Sydney, Taipei, Tokyo, Toronto, Warsaw

**Legg Mason Investor Services**  
Baltimore, New York, Stamford

**Permal Group**  
London, New York, Boston, Dubai, Hong Kong, Nassau, Paris, Singapore, Tokyo

**Private Capital Management**  
Naples, FL

**Royce & Associates**  
New York

**Western Asset Management**  
Pasadena, Hong Kong, London, Melbourne, New York, São Paulo, Singapore, Tokyo



“Our mission...To remain a leader in diversified fixed income investment management with integrated global operations, exercising uncompromising standards of excellence and ethics in all aspects of our business.”

Western Asset is one of the world’s largest and leading managers of fixed income investments, with over \$455 billion of assets under management. With a combined staff of 910 employees, Western Asset offers a broad range of fixed income investment services representing a global array of currencies, investment strategies and markets. Western Asset has 155 products, managed globally, in 16 currencies. Clients domiciled outside of the United States represented 39% of Western Asset’s total assets under management at year end.

Over the past 13 years, under the leadership of CEO Jim Hirschmann, Western Asset has successfully executed its strategic plan that has guided the

company for many years and remains the model for growth today:

- Be global, with a global platform and operations;
- Be seamlessly integrated in the way it operates its business;
- Continue diversifying its product line, with the ultimate aim of providing any fixed income solution that its clients may require, in any currency; and
- Achieve operational leverage within its organization through sizable, ongoing investments in technology and key support functions, as a way to support and protect the ability of its investment professionals to focus on their jobs of managing their clients’ money.







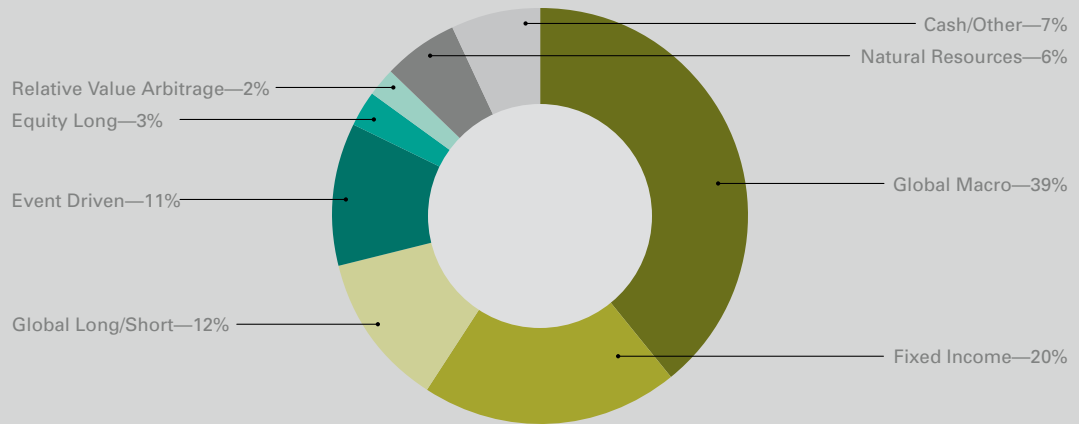
The Permal Group is one of the oldest and largest fund-of-hedge-fund managers in the world, with over \$20 billion in assets under management. The company offers a variety of investment programs covering different geographic regions, investment strategies and risk/return objectives. Permal's products also include both directional and absolute return strategies.

Permal's principal asset management offices are in London and New York, with offices in Dubai, Hong Kong, Nassau, Paris, Singapore, and Tokyo providing client service and investment research support, and an office in Boston housing its private equity group. Through its worldwide network of distributors, which includes many of the world's largest banks and securities firms, Permal has

developed an increasingly institutional and global client base.

Permal is well recognized for its strong, and well-established record of performance. Permal's more than 35 years of experience with hedge funds, its strong capabilities in fundamental analysis and its highly sophisticated analytic and risk management tools have enabled it to structure and manage highly diversified portfolios of specialized managers and distinct investment styles that have achieved a solid record of performance. Permal's assets under management increased by 19% during the year due to continuing strong performance and net client inflows. Ten of Permal's 14 multimanager fund offerings are rated by Standard & Poor's, of which one is AAA-rated, 7 are AA-rated and 2 are A-rated.

### Multi-Manager Funds' Assets by Strategy



# Royce & Associates

For more than 35 years, Royce & Associates has utilized a disciplined value approach to investing in smaller-cap companies. The company, which was founded by president and co-chief investment officer Chuck Royce, is particularly well-known for its family of mutual funds, The Royce Funds. Unlike many mutual fund groups with broad product offerings, Royce has chosen to concentrate on smaller company investing and provides investors with a range of options to take full advantage of this large and diverse sector.

Royce's investment strategy focuses on achieving above-average, long-term results. The investment team uses a bottom-up, value-oriented approach to investing, seeking companies with strong balance sheets and above-average returns on invested capital that are trading at substantial discounts to their intrinsic value. Although actual stock selection approaches

employed by individual fund managers may vary, portfolio companies are selected primarily from the smaller stock universe, defined as those with market caps up to \$5 billion. Royce pays close attention to risk and strives to maintain consistency and discipline, regardless of market movements and trends.

Royce & Associates, headquartered in New York, has an investment staff of 34 professionals that includes 17 portfolio managers, each with over 15 years of experience. The firm manages approximately \$44 billion of assets through 30 open-end mutual funds, two variable annuity funds and three closed-end funds, as well as institutional accounts and limited partnerships. In addition, Royce manages Legg Mason-sponsored funds offered outside the United States, utilizing our global fund distribution platform to expand their presence in targeted markets.

## Current Portfolio Characteristics

CATEGORY Fund	Portfolio Composition*		Portfolio Approach	Volatility
	Market Cap Breakdown	Non-U.S. Securities		
<b>CORE</b>				
Royce Pennsylvania Mutual Fund		0% ▼	Diversified	Low
Royce Heritage Fund		0%	Diversified	High
<b>CORE + DIVIDEND</b>				
Royce Total Return Fund		0% ▼	Diversified	Low
Royce Dividend Value Fund		0%	Diversified	Low
<b>FOCUSED</b>				
Royce Premier Fund		0%	Limited	Low
Royce Special Equity Fund		0% ▼	Limited	Low
Royce Value Fund		0%	Limited	High
Royce 100 Fund		0%	Limited	Moderate
<b>OPPORTUNISTIC THEMES</b>				
Royce Low-Priced Stock Fund		0%	Diversified	High
Royce Opportunity Fund		0% ▼	Diversified	High
Royce Value Plus Fund		0%	Diversified	High
<b>MICRO-CAP</b>				
Royce Micro-Cap Fund		0%	Diversified	Moderate
Royce Discovery Fund		0% ▼	Diversified	Moderate
<b>MID-CAP</b>				
Royce SMid-Cap Value Fund		0%	Limited	High
Royce Mid-Cap Fund**		0%	Limited	—
<b>GLOBAL/INTERNATIONAL</b>				
Royce Global Value Fund		0%	Limited	High
Royce International Smaller-Companies Fund**		0%	Diversified	—
Royce European Smaller-Companies Fund		0%	Limited	High

\* Source: FactSet

\*\* The Fund does not have the three years of history required for calculating a volatility score.

### Market Cap Breakdown:

■ Micro-Cap (up to \$500 million) ■ Small-Cap (between \$500 million and \$2.5 billion) ■ Mid-Cap (between \$2.5 billion and \$15 billion) ■ Large-Cap (above \$15 billion)





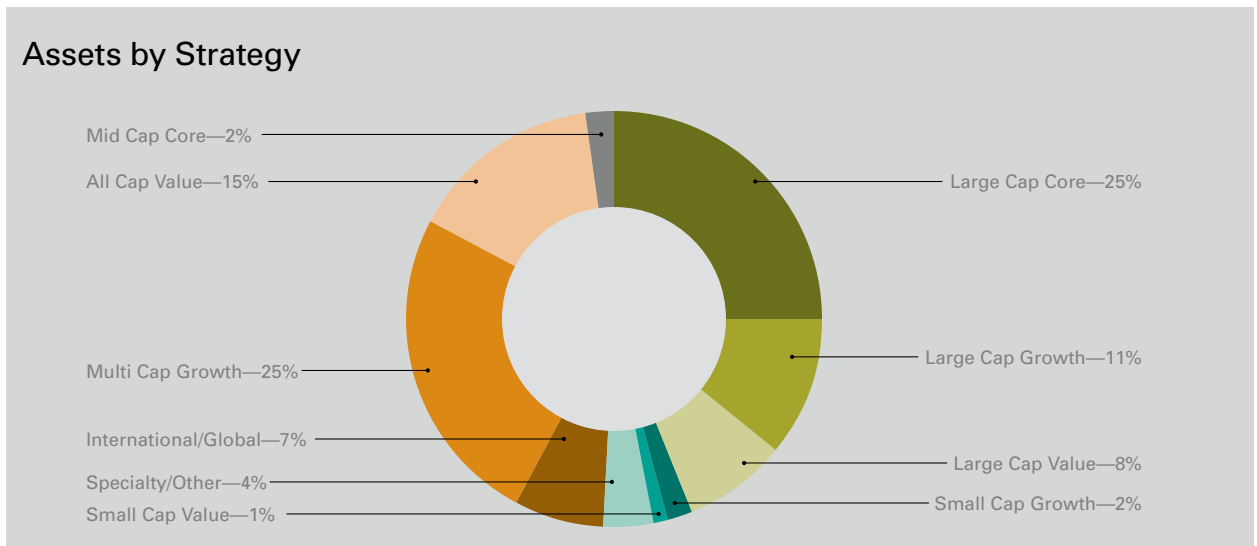
ClearBridge, our largest equity manager and our second-largest manager overall, manages nearly \$58 billion in assets. ClearBridge’s strategies are offered through a number of investment vehicles including mutual funds, separately managed accounts, commingled funds and limited partnerships. Its diversified portfolio of products is focused on four relevant themes: income solutions, high alpha, low volatility and global equities.

The ClearBridge platform offers a variety of investment styles, from small-cap value to large-cap growth, all utilizing a bottom-up, fundamental approach to security selection that is primarily research driven with a focus on companies with solid economic returns relative to their risk-adjusted valuations. In order to promote cross-fertilization, a collaborative approach exists between style-based portfolio managers and the research team. The distinct

investment philosophies and approaches of ClearBridge’s portfolio managers is united by a common, fundamentally-focused research platform with an emphasis on business models that they favor and can define, strong balance sheets and valuation.

The firm’s portfolio managers have strong track records in equity investing, with an average of 23 years of investment industry experience. ClearBridge currently has 130 employees, including 51 investment professionals, all of whom are based in the United States, in New York and San Francisco.

Global Currents, a Wilmington-based manager of international and global equity portfolios with assets under management of over \$3 billion, operates as a division of ClearBridge.





“BatteryMarch's mission is to provide consistent long-term value by exceeding client expectations in both performance and service. Our goal is to foster a culture that rewards creative, collaborative thinking and to leverage new technology to maximize the effectiveness of our entire organization.”

BatteryMarch, a pioneer in quantitative equity management, was one of the first U.S.-based managers to invest in international and emerging markets. Established in 1969, the Boston-based firm utilizes an adaptive, bottom-up process that combines the wisdom and experience of fundamental investors with the power and efficiency of quantitative tools.

As a global equity manager of both institutional separate accounts and subadvised funds, BatteryMarch invests in approximately 50 countries, with products that span the full range of equity asset classes. The company customizes its investment strategies to capture the intricacies of individual regions, countries and sectors.

All of BatteryMarch's investment strategies are collaborative and team driven, and incorporate rigorous stock selection, effective risk control and cost-efficient trading. BatteryMarch has 91 employees, including 27 investment professionals. Its clients represent a broad spectrum of investors, including corporate pension plans, public funds, foundations and endowments, Taft-Hartley plans and investment companies. More than half of BatteryMarch's nearly \$24 billion in assets under management represent global, international or emerging markets accounts, and over 35% is managed for clients domiciled outside the United States.

## Range of Investment Strategies



# LEGG MASON

## CAPITAL MANAGEMENT

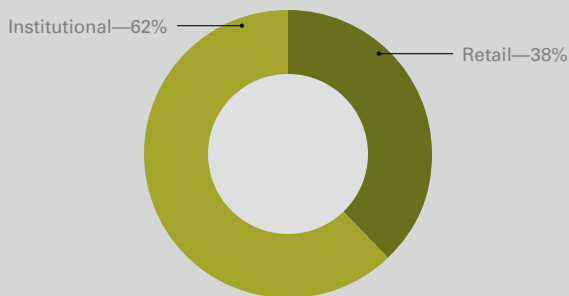
Legg Mason Capital Management (“LMCM”) was established in 1982 with the launch of its first equity mutual fund, Legg Mason Value Trust. Since then, LMCM has added additional mandates, as well as mutual fund and institutional separate account clients from around the globe. With over \$15 billion in assets under management, 22% is managed on behalf of non-U.S. domiciled clients.

The firm specializes in long-term, valuation-based investing with a focus on investment process, first and foremost. While LMCM’s intrinsic value investment philosophy has remained constant, the team continuously evaluates and improves the investment process to adapt to changing markets and gain a competitive advantage. This focus on process, rather than short-term outcomes, has led

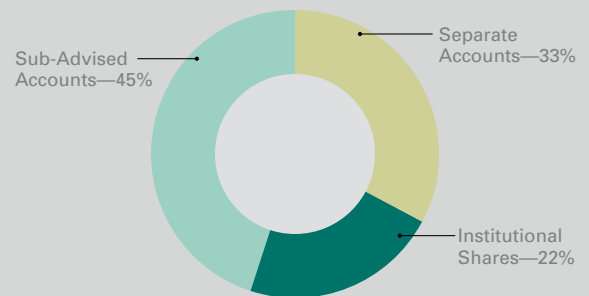
LMCM to take a multi-disciplinary approach to understanding businesses and markets.

Independence and diversity of thought are critical inputs to LMCM’s investment process. In order to gain a competitive advantage, LMCM embraces innovative and conceptual models that lie beyond the world of finance in areas like complex systems, science, technology and psychology, and apply them to its analysis of investment opportunities and risks. Additionally, LMCM strives to foster a culture that is conducive to rational, long-term, evidence-based decision-making. At the heart of LMCM is a cohesive team of nearly 30 investment professionals with diverse talents and perspectives, who apply the same investment philosophy and disciplined investment process across its multiple equity mandates.

### Retail and Institutional Assets



### Components of Institutional Assets





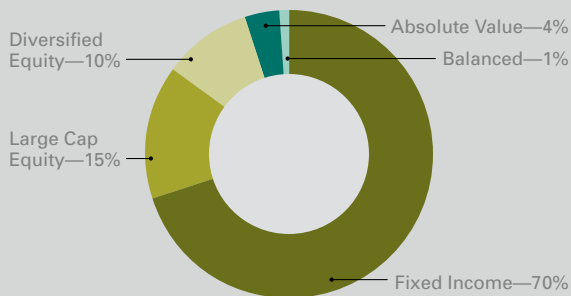
Since its founding in 1986, Brandywine Global has pursued a singular investment approach—value investing. Its assets under management today include an array of fixed income, equity, and balanced portfolios that invest in U.S., international, and global markets on behalf of over 375 institutional clients.

With approximately \$32 billion in assets under management, Brandywine Global’s growth has primarily been fueled by an increasing presence in international markets, with 36% of assets managed on behalf of non-U.S. domiciled clients. Its institutional client base includes public funds, corporations, educational institutions, Taft-Hartley plans, health care organizations, and high-net-worth individuals.

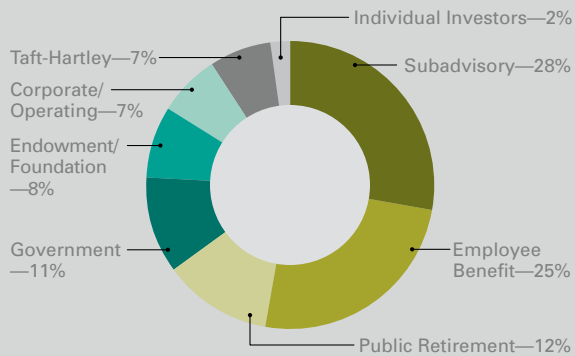
Brandywine Global has approximately 150 employees, including over 40 investment professionals, located in Philadelphia, San Francisco, London, and Singapore.

Brandywine Global works consistently to strengthen its fundamental and quantitative research capabilities and broaden their application to new securities and new markets. The company’s mission is to deliver superior investment solutions and performance to its clients by listening to its clients, hiring, supporting and retaining the industry’s best people, encouraging independent thinking by sponsoring an open marketplace for ideas, promoting a culture of integrity and partnership, and finding value, throughout the world, which others have not yet recognized.

### Assets by Strategy



### Assets by Client Type



# LEGG MASON Global Equities Group

The Legg Mason Global Equities Group is a collection of specialty firms dedicated to the global equities asset class. The group includes Esemplia Emerging Markets, Legg Mason Australian Equities, and Legg Mason managers largely dedicated to local equities based in Hong Kong and Poland. As with all of our managers, each affiliate operates with investment autonomy, pursuing its own unique investment philosophy and process and maintaining its own investment culture in order to create sustainable value for their clients. And collectively, they benefit from the global scale of Legg Mason to expand their reach and access to new client opportunities.



LEGG MASON  
Australian Equities

LEGG MASON  
Hong Kong

LEGG MASON  
Poland

## LEGG MASON INVESTMENT COUNSEL

Legg Mason Investment Counsel provides highly tailored investment and trust strategies for affluent individuals, family groups and institutions. Through an iterative and collaborative approach with its clients, the firm focuses on understanding goals and needs before building highly individualized strategies. Integral to its core investment capabilities, the firm has specializations in trust services, socially responsive investing, family office services, estate and tax planning and philanthropy to help clients achieve their financial goals. The firm operates from offices in Baltimore, where it is headquartered, as well as Cincinnati, Easton, New York and Philadelphia. Legg Mason Investment Counsel's dedicated team of 18 portfolio managers average 26 years of experience and its trust team 18 years of experience. The firm also employs 14 proprietary analysts whose work is for the benefit of the firm's clients only. Overall, the average client relationship approaches 20 years.

The foregoing information about Legg Mason, Inc. is designed to enhance stockholders' understanding of the company, which offers investment management products and services only through its various subsidiaries. Any information about these products and services is not intended to be an offer or solicitation to investors. All investment products or services are only offered and managed by one or more of the company's subsidiaries, and only such subsidiaries, or persons authorized by such subsidiaries, may make offers or solicitations to investors regarding such products or services in accordance with applicable policies and requirements, including eligibility and other criteria.



## Board of Directors

Standing, left to right:

**Robert E. Angelica**  
Private Investor; Former Chairman and CEO,  
AT&T Investment Management Corporation

**Nicholas J. St. George**  
Private Investor

**Kurt L. Schmoke**  
Dean, School of Law at Howard University;  
Former Mayor of Baltimore

**Cheryl Gordon Krongard**  
Private Investor; Former CEO, Rothschild Asset Management

**Dennis R. Beresford**  
Professor, University of Georgia; Former Chairman of Financial  
Accounting Standards Board (Chairman of Audit Committee)

**Mark R. Fetting**  
Chairman and Chief Executive Officer, Legg Mason, Inc.

**W. Allen Reed**  
Private Investor; Retired CEO, GM Asset Management  
Corporation (Lead Independent Director and Chairman  
of Nominating & Corporate Governance Committee)

**Nelson Peltz**  
Chief Executive Officer and Founding Partner,  
Triun Fund Management, L.P.

**Barry W. Huff**  
Retired Vice Chairman, Deloitte  
(Chairman of Risk Committee)

Seated, left to right:

**John E. Koerner III**  
Managing Member, Koerner Capital, LLC

**John T. Cahill**  
Industrial Partner, Ripplewood Holdings, LLC  
(Chairman of Finance Committee)

**Harold L. Adams**  
Chairman Emeritus, RTKL Associates, Inc.  
(Chairman of Compensation Committee)

**Margaret Milner Richardson**  
Private Consultant and Investor; Former U.S.  
Commissioner of Internal Revenue

**Scott C. Nuttall**  
Member, Kohlberg Kravis Roberts & Co.



# Selected Financial Data

(Dollars in thousands, except per share amounts or unless otherwise noted)

	Years Ended March 31,				
	2011	2010	2009	2008	2007
<b>OPERATING RESULTS</b>					
Operating revenues	\$2,784,317	\$2,634,879	\$ 3,357,367	\$ 4,634,086	\$4,343,675
Operating expenses, excluding impairment	2,397,509	2,313,696	2,718,577	3,432,910	3,315,377
Impairment of goodwill and intangible assets	—	—	1,307,970	151,000	—
Operating income (loss)	386,808	321,183	(669,180)	1,050,176	1,028,298
Other non-operating income (expense)	(23,315)	(32,027)	(243,577)	(5,573)	15,556
Other income (expense) of consolidated investment vehicles	1,704	17,329	7,796	—	—
Fund support	—	23,171	(2,283,236)	(607,276)	—
Income (loss) from continuing operations before income tax provision (benefit)	365,197	329,656	(3,188,197)	437,327	1,043,854
Income tax provision (benefit)	119,434	118,676	(1,223,203)	173,496	397,612
Income (loss) from continuing operations	245,763	210,980	(1,964,994)	263,831	646,242
Gain on sale of discontinued operations, net of tax <sup>(1)</sup>	—	—	—	—	572
Net income (loss)	245,763	210,980	(1,964,994)	263,831	646,814
Less: Net income (loss) attributable to noncontrolling interests	(8,160)	6,623	2,924	266	(4)
Net income (loss) attributable to Legg Mason, Inc.	\$ 253,923	\$ 204,357	\$(1,967,918)	\$ 263,565	\$ 646,818
Net income (loss) from continuing operations attributable to Legg Mason, Inc.	\$ 253,923	\$ 204,357	\$(1,967,918)	\$ 263,565	\$ 646,246
<b>PER SHARE</b>					
Net income (loss) per share attributable to Legg Mason, Inc. common shareholders:					
Basic	\$ 1.63	\$ 1.33	\$ (13.99)	\$ 1.86	\$ 4.58
Diluted	\$ 1.63	\$ 1.32	\$ (13.99)	\$ 1.83	\$ 4.48
Weighted-average shares outstanding:					
Basic	155,321	153,715	140,669	142,018	141,112
Diluted <sup>(2)</sup>	155,484	155,362	140,669	143,976	144,386
Dividends declared	\$ .20	\$ .12	\$ .96	\$ .96	\$ .81
<b>BALANCE SHEET</b>					
Total assets	\$8,707,756	\$8,622,632	\$ 9,232,299	\$11,830,352	\$9,604,488
Long-term debt	1,201,868	1,170,334	2,740,190	1,992,231	1,112,624
Total stockholders' equity	5,770,384	5,841,724	4,598,625	6,784,641	6,541,490
<b>FINANCIAL RATIOS AND OTHER DATA</b>					
Adjusted income (loss) per diluted share <sup>(3)</sup>	\$ 2.83	\$ 2.45	\$ (8.47)	\$ 6.11	\$ 5.86
Operating margin	13.9%	12.2%	(19.9)%	22.7%	23.7%
Operating margin, as adjusted <sup>(4)</sup>	23.2%	20.7%	23.9%	35.5%	33.1%
Total debt to total capital <sup>(5)</sup>	20.1%	19.6%	39.4%	26.9%	14.5%
Assets under management ( <i>in millions</i> )	\$ 677,646	\$ 684,549	\$ 632,404	\$ 950,122	\$ 968,510
Full-time employees	3,395	3,550	3,890	4,220	4,030

(1) All attributable to Legg Mason, Inc.

(2) Basic shares and diluted shares are the same for periods with a net loss.

(3) Adjusted Income (Loss) (formerly "Cash Income, As Adjusted") is a non-GAAP performance measure. We define Adjusted Income (Loss) as Net Income (Loss) from Continuing Operations Attributable to Legg Mason, Inc., plus amortization and deferred taxes related to intangible assets and goodwill, and imputed interest and tax benefits on contingent convertible debt less deferred income taxes on goodwill and intangible asset impairment, if any. We also adjust for non-core items that are not reflective of our economic performance, such as impairment charges and the impact of tax rate adjustments on certain deferred tax liabilities related to indefinite-life intangible assets and goodwill, and net money market fund support losses (gains). See Supplemental Non-GAAP Information in Management's Discussion and Analysis of Financial Condition and Results of Operations.

(4) Operating margin, as adjusted, is a non-GAAP performance measure we calculate by dividing (i) Operating Income, adjusted to exclude the impact on compensation expense of gains or losses on investments made to fund deferred compensation plans, the impact on compensation expense of gains or losses on seed capital investments by our affiliates under revenue sharing agreements, transition-related costs of streamlining our business model, income (loss) of consolidated investment vehicles, and impairment charges by (ii) our operating revenues, adjusted to add back net investment advisory fees eliminated upon consolidation of investment vehicles, less distribution and servicing expenses which we use as an approximate measure of revenues that are passed through to third-parties, which we refer to as "adjusted operating revenues." See Supplemental Non-GAAP Information in Management's Discussion and Analysis of Financial Condition and Results of Operations.

(5) Calculated based on total debt as a percentage of total capital (total stockholders' equity plus total debt) as of March 31.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## EXECUTIVE OVERVIEW

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 and the United Kingdom and also have offices in Australia, Bahamas, Brazil, Canada, Chile, China, Dubai, France, Germany, Italy, Japan, Luxembourg, Poland, Singapore, Spain and Taiwan.

We currently operate in one reportable business segment, Asset Management, and manage our business in two divisions or operating segments, Americas and International, which are primarily based on the geographic location of the advisor or the domicile of fund families we manage. The Americas division consists of our U.S.-domiciled fund families, the separate account businesses of our U.S.-based investment affiliates and the domestic distribution organization. Similarly, the International Division consists of our fund complexes, distribution teams and investment affiliates located outside the U.S. In December 2010, we announced a realignment of our executive management team which, among other things, will eliminate the previous separation of the Americas and International divisions into one Global Asset Management business during fiscal 2012. We believe this new structure will allow us to function as a global organization with a single purpose and allow us to focus on future growth opportunities. As of March 31, 2011, there has been no change to the internal executive management reporting and we continued to operate in one reportable business segment, Asset Management, with two divisions, Americas and International.

Our operating revenues primarily consist of investment advisory fees, from separate accounts and funds, and distribution and service fees. Investment advisory fees are generally calculated as a percentage of the assets of the investment portfolios that we manage. In addition, performance fees may be earned under certain investment advisory contracts for exceeding performance benchmarks. Distribution and service fees are fees received for distributing investment products and services or for providing other support services to investment portfolios, and are generally calculated as a percentage of the assets in an

investment portfolio or as a percentage of new assets added to an investment portfolio. Our revenues, therefore, are dependent upon the level of our assets under management, and thus are affected by factors such as securities market conditions, our ability to attract and maintain assets under management and key investment personnel, and investment performance. Our assets under management primarily vary from period to period due to inflows and outflows of client assets and market performance. Client decisions to increase or decrease their assets under our management, and decisions by potential clients to utilize our services, may be based on one or more of a number of factors. These factors include our reputation in the marketplace, the investment performance, both absolute and relative to benchmarks or competitive products, of our products and services, the fees we charge for our investment services, the client or potential client's situation, including investment objectives, liquidity needs, investment horizon and amount of assets managed, our relationships with distributors and the external economic environment, including market conditions.

The fees that we charge for our investment services vary based upon factors such as the type of underlying investment product, the amount of assets under management, and the type of services (and investment objectives) that are provided. Fees charged for equity asset management services are generally higher than fees charged for fixed income and liquidity asset management services. Accordingly, our revenues will be affected by the composition of our assets under management. In addition, in the ordinary course of our business, we may reduce or waive investment management fees, or limit total expenses, on certain products or services for particular time periods to manage fund expenses, or for other reasons, and to help retain or increase managed assets. Under revenue sharing agreements, certain of our affiliates retain different percentages of revenues to cover their costs, including compensation. As such, our Net income attributable to Legg Mason, Inc., operating margin and compensation as a percentage of operating revenues are impacted based on which affiliates generate our revenues, and a change in assets under management at one subsidiary can have a dramatically different effect on our revenues and earnings than an equal change at another subsidiary. In addition, from time to time we may agree to changes in revenue sharing agreements and other arrangements with our asset management personnel, which may impact our compensation expenses and profitability.

The most significant component of our cost structure is employee compensation and benefits, of which a majority is variable in nature and includes incentive compensation that is primarily based upon revenue levels and profits. The next largest component of our cost structure is distribution and servicing fees, which are primarily fees paid to third-party distributors for selling our asset management products and services and are largely variable in nature. Certain other operating costs are fixed in nature, such as occupancy, depreciation and amortization, and fixed contract commitments for market data, communication and technology services, and usually do not decline with reduced levels of business activity or, conversely, usually do not rise proportionately with increased business activity.

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. The economic downturn of fiscal years 2008 and 2009 contributed to a significant contraction in our business. We have experienced improvement over the past two years, although we have not recovered to pre-downturn levels.

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, 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 impacted by the regulatory and legislative changes. Responding to these changes has required, and will continue to require, us to incur costs that continue to impact our profitability.

All references to fiscal 2011, 2010 or 2009 refer to our fiscal year ended March 31 of that year. Terms such as "we," "us," "our," and "Company" refer to Legg Mason.

## BUSINESS ENVIRONMENT AND RESULTS OF OPERATIONS

The financial environment globally and in the United States continued to rebound during fiscal 2011, but challenging conditions persisted throughout most of our fiscal year due to uncertainties surrounding the strength of the economic recovery, continued concerns over budget deficits, and high levels of unemployment. The impact of the earthquake that occurred in Japan in March 2011, along with political unrest in the Middle East, have created new uncertainties.

In spite of these global concerns, the markets continued to increase due to steady improvement in consumer confidence, stabilization of still elevated unemployment rates, and improved performance in corporate earnings across many sectors. During fiscal 2011, the Federal Reserve Board held the discount rate at 0.25%, the lowest in history. The financial environment in which we operate continues to be challenging moving into fiscal 2012.

All three major U.S. equity market indices, as well as the Barclays Capital U.S. Aggregate Bond Index and Barclays Capital Global Aggregate Bond Index, increased significantly during the past two fiscal years as illustrated in the table below:

Indices <sup>(1)</sup>	% Change for the year ended March 31,	
	2011	2010
Dow Jones Industrial Average	<b>13.48%</b>	42.68%
S&P 500	<b>13.37%</b>	46.57%
NASDAQ Composite Index	<b>15.98%</b>	56.87%
Barclays Capital U.S. Aggregate Bond Index	<b>5.12%</b>	7.69%
Barclays Capital Global Aggregate Bond Index	<b>7.15%</b>	10.23%

(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.



The following table sets forth, for the periods indicated, amounts in the Consolidated Statements of Income as a percentage of operating revenues and the increase (decrease) by item as a percentage of the amount for the previous period:

	Percentage of Operating Revenues			Period to Period Change <sup>(1)</sup>	
	2011	Years Ended March 31, 2010	2009	2011 Compared to 2010	2010 Compared to 2009
<b>Operating Revenues</b>					
Investment advisory fees					
Separate accounts	<b>29.3%</b>	30.9%	30.3%	<b>0.1%</b>	(19.9)%
Funds	<b>53.4</b>	51.9	54.7	<b>8.7</b>	(25.5)
Performance fees	<b>3.5</b>	2.7	0.5	<b>35.3</b>	310.0
Distribution and service fees	<b>13.6</b>	14.3	14.2	<b>1.0</b>	(21.0)
Other	<b>0.2</b>	0.2	0.3	<b>4.6</b>	(47.6)
Total operating revenues	<b>100.0</b>	100.0	100.0	<b>5.7</b>	(21.5)
<b>Operating Expenses</b>					
Compensation and benefits	<b>41.0</b>	42.2	33.7	<b>2.6</b>	(1.8)
Transition-related compensation	<b>1.6</b>	—	—	<b>n/m</b>	n/m
Total compensation and benefits	<b>42.6</b>	42.2	33.7	<b>6.7</b>	(1.8)
Distribution and servicing	<b>25.6</b>	26.3	28.9	<b>3.0</b>	(28.7)
Communications and technology	<b>5.8</b>	6.2	5.6	<b>(0.7)</b>	(13.4)
Occupancy	<b>5.0</b>	6.0	6.2	<b>(12.2)</b>	(25.1)
Amortization of intangible assets	<b>0.8</b>	0.8	1.1	<b>0.6</b>	(37.6)
Impairment of goodwill and intangible assets	<b>—</b>	—	39.0	<b>n/m</b>	n/m
Other	<b>6.3</b>	6.3	5.4	<b>5.3</b>	(7.9)
Total operating expenses	<b>86.1</b>	87.8	119.9	<b>3.6</b>	(42.5)
<b>Operating Income (Loss)</b>	<b>13.9</b>	12.2	(19.9)	<b>20.4</b>	n/m
<b>Other Income (Expense)</b>					
Interest income	<b>0.3</b>	0.3	1.7	<b>25.7</b>	(86.9)
Interest expense	<b>(3.3)</b>	(4.8)	(5.5)	<b>(27.0)</b>	(30.9)
Fund support	<b>—</b>	0.9	(68.0)	<b>n/m</b>	n/m
Other	<b>2.1</b>	3.2	(3.5)	<b>(31.4)</b>	n/m
Other non-operating income (expense) of consolidated investment vehicles	<b>0.1</b>	0.7	0.2	<b>(90.2)</b>	n/m
Total other income (expense)	<b>(0.8)</b>	0.3	(75.1)	<b>n/m</b>	n/m
<b>Income (Loss) before Income Tax Provision (Benefit)</b>	<b>13.1</b>	12.5	(95.0)	<b>10.8</b>	n/m
Income tax provision (benefit)	<b>4.3</b>	4.5	(36.5)	<b>0.6</b>	n/m
<b>Net Income (Loss)</b>	<b>8.8</b>	8.0	(58.5)	<b>16.5</b>	n/m
Less: Net income (loss) attributable to noncontrolling interest	<b>(0.3)</b>	0.2	0.1	<b>n/m</b>	n/m
<b>Net Income (Loss) Attributable to Legg Mason, Inc.</b>	<b>9.1%</b>	7.8%	(58.6)%	<b>24.3</b>	n/m

n/m—not meaningful

(1) Calculated based on the change in actual amounts between fiscal years as a percentage of the prior year amount.

## FISCAL 2011 COMPARED WITH FISCAL 2010

### Financial Overview

Net income attributable to Legg Mason, Inc. for the year ended March 31, 2011 totaled \$253.9 million, or \$1.63 per diluted share, compared to \$204.4 million, or \$1.32 per diluted share, in the prior year. The increase in Net Income was primarily due to the net impact of increased operating revenues, reflecting a more favorable asset mix and increased performance fees, reduced interest expense, and a change in the U.K. tax rate. These increases were offset in part by the impact of transition-related compensation, the impact of gains on fund support recognized in the prior year, and an increase in costs associated with closed-end fund launches. These items are further discussed in "Results of Operations" below. Adjusted Income (see Supplemental Non-GAAP Financial Information) was \$439.2 million, or \$2.83 per diluted share, compared to \$381.3 million, or \$2.45 per diluted share, in the prior year. This increase was primarily due to the increase in Net Income, as previously discussed, excluding the impact of the current year U.K. tax rate change and fund support gains in the prior year. Operating margin increased to 13.9% from 12.2% in the prior year. Operating margin, as adjusted (see Supplemental Non-GAAP Financial Information) increased to 23.2% from 20.7% in the prior year.

### Assets Under Management

The components of the changes in our assets under management ("AUM") (in billions) for the years ended March 31 were as follows:

	2011	2010
Beginning of period	<b>\$684.5</b>	\$632.4
Investment funds, excluding liquidity funds <sup>(1)</sup>		
Subscriptions	<b>49.5</b>	38.8
Redemptions	<b>(44.3)</b>	(40.2)
Separate account flows, net	<b>(52.1)</b>	(76.5)
Liquidity fund flows, net	<b>(14.2)</b>	(4.1)
Net client cash flows	<b>(61.1)</b>	(82.0)
Market performance and other <sup>(2)</sup>	<b>56.3</b>	134.1
Dispositions	<b>(2.1)</b>	—
End of period	<b>\$677.6</b>	\$684.5

(1) Subscriptions and redemptions reflect the gross activity in the funds and include assets transferred between funds and between share classes.

(2) Includes impact of foreign exchange.

AUM at March 31, 2011 was \$678 billion, a decrease of \$7 billion or 1% from March 31, 2010. The decrease in AUM was attributable to net client outflows of \$61 billion, which were partially offset by market appreciation of \$56 billion, of which approximately 17% resulted

from the impact of foreign currency exchange fluctuation, and dispositions of \$2 billion, relating to the sale of a Singapore-based Asian equity manager. The majority of outflows were in fixed income with \$37 billion, or 61% of the outflows, followed by liquidity outflows and equity outflows of \$16 billion and \$8 billion, respectively. The majority of fixed income outflows were in products managed by Western Asset Management Company ("Western Asset"). We have experienced outflows in our fixed income asset class since fiscal 2008. Equity outflows were primarily experienced by products managed at ClearBridge Advisors LLC ("ClearBridge") and Legg Mason Capital Management, Inc. ("LMCM"), while The Permal Group, Ltd. ("Permal") and Royce & Associates ("Royce") had net inflows. Due in part to investment performance issues, we have experienced net annual equity outflows since fiscal 2007. However, the rate of outflows in this asset class was lower year over year. We generally earn higher fees and profits on equity AUM, and outflows in this asset class will more negatively impact our revenues and net income than would outflows in other asset classes.

During the first quarter of fiscal 2012, Morgan Stanley Smith Barney amended certain historical Smith Barney brokerage programs providing for investment in liquidity funds that our asset managers manage, that resulted in a reduction of approximately \$16 billion in liquidity AUM. We are currently waiving much of the management fees generated by these assets, so a loss of this AUM this year would have reduced net advisory revenue by only \$8 million and not had a material impact on Net Income due to the impact of revenue sharing arrangements and income taxes. In addition, we expect further amendments to result in an additional \$7 billion in liquidity assets being transferred over the next 15 months.

Our investment advisory and administrative contracts are generally terminable at will or upon relatively short notice, and investors in the mutual funds that we manage may redeem their investments in the funds at any time without prior notice. Institutional and individual clients can terminate their relationships with us, reduce the aggregate amount of assets under management, or shift their funds to other types of accounts with different rate structures for any number of reasons, including investment performance, changes in prevailing interest rates, changes in our reputation in the marketplace, changes in management or control of clients or third-party distributors with whom we have relationships, loss of key investment management personnel or financial market performance.

### AUM by Asset Class

AUM by asset class (in billions) as of March 31 were as follows:

	2011	% of Total	2010	% of Total	% Change
Equity	\$189.6	28.0	\$173.8	25.4	9.1
Fixed income	356.6	52.6	364.3	53.2	(2.1)
Liquidity	131.4	19.4	146.4	21.4	(10.2)
Total	\$677.6	100.0	\$684.5	100.0	(1.0)

The component changes in our AUM by asset class (in billions) for the fiscal year ended March 31, 2011 were as follows:

	Equity	Fixed Income	Liquidity	Total
March 31, 2010	\$173.8	\$364.3	\$146.4	\$684.5
Investment funds, excluding liquidity funds				
Subscriptions	23.4	26.1	—	49.5
Redemptions	(24.7)	(19.6)	—	(44.3)
Separate account flows, net	(6.9)	(43.5)	(1.7)	(52.1)
Liquidity fund flows, net	—	—	(14.2)	(14.2)
Net client cash flows	(8.2)	(37.0)	(15.9)	(61.1)
Market performance and other	24.0	29.3	0.9	54.2
<b>March 31, 2011</b>	<b>\$189.6</b>	<b>\$356.6</b>	<b>\$131.4</b>	<b>\$677.6</b>

Average AUM by asset class (in billions) for the year ended March 31 were as follows:

	2011	% of Total	2010	% of Total	% Change
Equity	\$173.8	26.0	\$155.7	23.0	11.6
Fixed income	361.6	54.0	370.7	54.9	(2.5)
Liquidity	133.8	20.0	149.1	22.1	(10.3)
Total	\$669.2	100.0	\$675.5	100.0	(0.9)

### AUM by Division

AUM by division (in billions) as of March 31 were as follows:

	2011	% of Total	2010	% of Total	% Change
Americas	\$476.8	70.4	\$475.8	69.5	0.2
International	200.8	29.6	208.7	30.5	(3.8)
Total	\$677.6	100.0	\$684.5	100.0	(1.0)

The component changes in our AUM by division (in billions) for the year ended March 31, 2011 were as follows:

	Americas	International	Total
March 31, 2010	\$475.8	\$208.7	\$684.5
Investment funds, excluding liquidity funds			
Subscriptions	28.7	20.8	49.5
Redemptions	(32.6)	(11.7)	(44.3)
Separate account flows, net	(32.0)	(20.1)	(52.1)
Liquidity fund flows, net	(8.1)	(6.1)	(14.2)
Net client cash flows	(44.0)	(17.1)	(61.1)
Market performance and other	45.0	9.2	54.2
<b>March 31, 2011</b>	<b>\$476.8</b>	<b>\$200.8</b>	<b>\$677.6</b>



### Investment Performance<sup>(1)</sup>

Investment performance of our assets under management in the year ended March 31, 2011 was mixed compared to relevant benchmarks from the prior year.

The equity markets worked through a difficult year with more recent political upheaval in the Middle East driving a significant increase in oil prices and the earthquake in Japan and subsequent nuclear crisis raising questions about the future of the nuclear power industry. Despite these global concerns, most U.S. indices produced positive returns for our fourth fiscal quarter and our full fiscal year driven by corporate earnings growth resulting in increases in dividends, share buybacks, and mergers and acquisitions activity.

In the fixed income markets, relatively strong economic data, combined with continued accommodative monetary and fiscal policy, continued to alleviate fears of a double-dip recession and caused U.S Treasury yields to rise across the yield curve.

The yield curve slightly flattened over the quarter and the year as the Federal Reserve kept its funds rate at 0.25% and reiterated that rates would be kept low for an extended period. The worst performing fixed income sector for the year was Government bonds as measured by the Barclays U.S. Government Bond Index returning 4.28%, in contrast to High Yield Bonds, as measured by the Barclays High Yield Bond Index, which returned 14.31% followed by U.S. TIPS, as measured by the Barclays U.S. TIPS Index, which returned 7.91% for the year.

The following table presents a summary of the percentage of our marketed composite assets<sup>(2)</sup> that outpaced their benchmarks as of March 31, 2011 and 2010, for the trailing 1-year, 3-year, 5-year, and 10-year periods:

	As of March 31, 2011				As of March 31, 2010			
	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year
Equity	42%	57%	61%	77%	49%	61%	72%	86%
Fixed income	82%	80%	70%	81%	88%	40%	50%	88%

The following table presents a summary of the percentage of our U.S. mutual fund assets<sup>(3)</sup> that outpaced their Lipper category averages as of March 31, 2011 and 2010, for the trailing 1-year, 3-year, 5-year, and 10-year periods:

	As of March 31, 2011				As of March 31, 2010			
	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year
Total long-term	56%	74%	70%	67%	62%	68%	70%	80%
Equity	58%	70%	68%	60%	51%	63%	65%	78%
Fixed income	52%	83%	78%	85%	81%	78%	83%	87%

### Revenue by Division

Operating revenues by division (in millions) for the years ended March 31 were as follows:

	2011	% of Total	2010	% of Total	% Change
Americas	\$1,917.9	68.9	\$1,864.2	70.8	2.9
International	866.4	31.1	770.7	29.2	12.4
Total	\$2,784.3	100.0	\$2,634.9	100.0	5.7

The increase in operating revenues in the Americas division was primarily due to increased mutual fund advisory fees on assets managed by Royce. The increase in operating revenues in the International division was primarily due to increased mutual fund advisory fees and performance fees on assets managed by the international operations of Western Asset and increased fund revenues at Pernal.

(1) Index performance in this section includes reinvestment of dividends and capital gains.

(2) A composite is an aggregation of discretionary portfolios (separate accounts and investment funds) into a single group that represents a particular investment objective or strategy. Each of our asset managers has its own specific guidelines for including portfolios in its marketed composites. Assets under management that are not managed in accordance with the guidelines are not included in a composite. As of March 31, 2011 and 2010, 89% and 87% of our equity assets under management, respectively, in each period, and 89% and 82%, of our fixed income assets under management, respectively, were in marketed composites.

(3) Source: Lipper Inc. includes open-end, closed-end, and variable annuity funds. As of March 31, 2011 and 2010, the U.S. long-term mutual fund assets represented in the data accounted for 17% and 16%, respectively, of our total assets under management. The performance of our U.S. long-term mutual fund assets is included in the marketed composites.

### **Business Model Streamlining Initiative**

In May 2010, we announced an initiative to streamline our business model to drive increased profitability and growth that includes: (i) transitioning certain shared services to our investment affiliates which are closer to the actual client relationships; and (ii) sharing in affiliate revenue with our Americas distribution group. We project that the initiative will result in \$130 million to \$150 million in expense reductions that will be fully realized on an annualized basis by the fourth quarter of fiscal 2012. These expense savings consist of (i) approximately \$75 million in compensation and benefits cost reductions from eliminating positions in certain corporate shared services functions as a result of transitioning such functions to the affiliates, and charging affiliates for other centralized services that will continue to be provided to them without any corresponding adjustment in revenue sharing or other compensation arrangements; (ii) approximately \$50 million in non-compensation costs from eliminating and streamlining activities in our corporate and distribution business units, including savings associated with consolidating office space; and (iii) approximately \$15 million from our Americas distribution group sharing in affiliate revenues from retail assets under management without any corresponding adjustment in revenue sharing or other compensation arrangements.

The initiative involves approximately \$115 million to \$135 million in transition-related costs that primarily include charges for employee termination benefits and incentives to retain employees during the transition period. The transition-related costs will also include charges for consolidating leased office space, early contract terminations, asset disposals and professional fees. During fiscal 2011, transition-related costs totaled \$54.4 million, which, net of related cost-savings, reduced our operating income by \$42 million. Substantially all of the remaining costs will be accrued in fiscal 2012.

The nature and amount of transition costs and savings are based on estimates. While management expects the total costs and savings to be within the ranges disclosed, actual results may differ in amount and nature from these estimates. The achievement of all projected cost savings and margin improvements, as well as the amount and nature of transition-related costs, will be subject to many factors, including market conditions and other factors affecting our financial results, and those of our affiliates, and the rate of

AUM growth. In addition, our business is dynamic and may require us to incur incremental expenses from time-to-time to grow and better support our business. See Note 16 of Notes to Consolidated Financial Statements for additional information on our business streamlining initiative.

### **RESULTS OF OPERATIONS**

Effective with the April 1, 2010 adoption of a new accounting standard on consolidation, we consolidate and separately identify 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 our consolidated operating results. We also hold investments in certain consolidated sponsored investment funds and the change in the value of these investments, which is recorded in Other non-operating income (expense), is reflected in our Net Income, net of amounts allocated to noncontrolling interests. The impact of the consolidation of investment vehicles is presented in our "Consolidated Statements of Income, Excluding Consolidated Investment Vehicles" (See Supplemental Non-GAAP Financial Information). Also, see Notes 1 and 18 of Notes to Consolidated Financial Statements for additional information regarding the consolidation of investment vehicles.

#### **Operating Revenues**

Total operating revenues for the year ended March 31, 2011 were \$2.8 billion, an increase of 6% from \$2.6 billion in the prior year, despite a 1% decrease in average AUM, reflecting increased revenue yields due to a more favorable asset mix and higher performance fees. These increases were offset in part by an increase in fee waivers on certain liquidity funds in order to maintain certain yields to investors.

Investment advisory fees from separate accounts were relatively flat at \$815.6 million, as a decrease of \$25.4 million, resulting from lower average fixed income assets at Western Asset, was offset by an \$18.6 million increase due to higher average equity assets managed by Batterymarch Financial Management, Inc. ("Batterymarch") and Royce, a \$5.1 million increase due to higher average fixed income assets managed by Brandywine Global Management, LLC ("Brandywine"), and a \$2.2 million increase due to subordinate fees received from certain CLOs managed by Western Asset.

Investment advisory fees from funds increased \$119.3 million, or 9%, to \$1.5 billion. Of this increase, \$111.5 million was the result of higher average equity assets managed at Royce, Permal, and ClearBridge, and \$84.4 million was the result of higher average fixed income assets managed at Western Asset. These increases were offset in part by a \$45.7 million decrease due to lower average liquidity assets managed at Western Asset and a \$36.0 million decrease as a result of fee waivers on liquidity funds managed by Western Asset, primarily to maintain certain yields to investors.

Performance fees increased 35%, or \$25.2 million, to \$96.7 million during fiscal 2011, driven by fees earned on assets managed at Western Asset, Permal and Brandywine.

Distribution and service fees increased 1% to \$379.2 million, primarily as a result of an increase in average mutual fund AUM subject to distribution and servicing fees offset in part by the impact of increased fee waivers related to liquidity funds managed by Western Asset.

### **Operating Expenses**

Total compensation and benefits increased \$74.1 million to \$1.2 billion. Compensation and benefits, excluding transition-related compensation of \$45.0 million, which represents severance and retention incentive costs, increased \$29.0 million, or 3%, to \$1.14 billion. This increase was driven by a \$68.6 million increase in revenue share-based compensation resulting from higher revenues and a reduction in operating expenses at revenue share-based affiliates in fiscal 2011 and a \$7.5 million increase in incentive compensation for non-revenue share-based affiliates and administrative and sales personnel. These increases were offset in part by a \$45.7 million reduction in deferred compensation obligations due to the impact of reduced market gains on assets invested for deferred compensation plans, which are recorded in Other non-operating income (expense), as well as, a \$6.1 million reduction in deferred compensation expense at non-revenue share-based affiliates. The impact of reduced headcount, primarily related to our business streamlining initiatives, also reduced compensation and benefits by \$6.0 million.

Compensation as a percentage of operating revenues increased to 42.6% from 42.2% in the prior fiscal year primarily due to the impact of increased revenues at revenue share-based affiliates that retain a higher

percentage of revenues as compensation, and transition-related compensation. These increases were substantially offset by the impact of compensation decreases related to reduced market gains on assets invested for deferred compensation plans and seed capital investments and the impact of lower corporate compensation on increased revenues.

We have an arrangement with an affiliate under which the affiliate's incentive compensation pool under a revenue sharing agreement has been reduced over the last two years to reimburse the parent company for certain expenses, while at the same time the parent company has provided an equivalent amount of deferred compensation to the affiliate's employees. A portion of the deferred compensation was granted in the form of restricted stock awards and the remainder in cash awards granted under a non-qualified plan, both of which will vest over periods of three to four years. The amount by which the affiliate's incentive compensation will be reduced in fiscal 2012 under the arrangement will be significantly less than the reduction in fiscal 2011. In addition, there will be an increase in the amount of non-cash amortization expense associated with the vesting of the deferred compensation awards from prior years. The combined impact will result in a \$74 million increase in compensation and benefits in fiscal 2012, which will be recognized ratably over the year. This arrangement will continue for the subsequent five years, however, the incremental effect on compensation expense from year to year will be far less significant.

Distribution and servicing expenses increased 3% to \$712.8 million, primarily as a result of an increase in average AUM in certain products for which we pay fees to third-party distributors and an increase of \$14.5 million in structuring fees related to closed-end fund launches offset in part by the impact of liquidity fund fee waivers that reduce the amounts paid to our distributors.

Communications and technology expense decreased 1% to \$162.0 million, of which \$9.2 million resulted from the full depreciation of certain assets prior to or during the current year, offset in part by a \$6.6 million increase in technology consulting and outsourcing fees, primarily related to our business streamlining initiatives.

Occupancy expense decreased 12% to \$137.9 million, primarily due to the impact of a \$19.3 million charge in the prior year as a result of subleasing space in our corporate headquarters in fiscal 2010.



Amortization of intangibles remained relatively flat at \$22.9 million.

Other expenses increased \$8.9 million to \$176.6 million, primarily as a result of a \$10.3 million increase in travel and entertainment and advertising costs, a \$5.6 million increase in state franchise taxes, a \$4.2 million increase in professional fees, and a \$5.4 million increase in charges related to trading errors and expense reimbursements paid to certain mutual funds. These increases were offset in part by the impact of a \$19.0 million investor settlement in the prior year.

### **Non-Operating Income (Expense)**

Interest income increased 26% to \$9.2 million driven by higher average interest rates, offset in part by a \$0.9 million decrease due to lower average investment balances.

Interest expense decreased 27% to \$92.2 million, primarily as a result of the exchange of our Equity Units in August 2009 and the repayment of the \$550 million outstanding term loan balance in January 2010, which reduced interest expense by \$14.8 million and \$12.2 million, respectively.

As of March 31, 2010, all fund support arrangements had expired or were terminated in accordance with their terms. Fund support gains were \$23.2 million in the prior year. The gains primarily represent the reversal of unrealized, non-cash losses recorded in fiscal 2009 on liquidity fund support arrangements for our offshore funds.

Other non-operating income (expense) decreased \$27.3 million, primarily as a result of a \$46.7 million reduction in unrealized market gains on assets invested for deferred compensation plans, which were substantially offset by corresponding compensation decreases discussed above, and a \$4.3 million reduction in unrealized market gains on investments in proprietary fund products. These decreases were offset in part by the impact of \$22.0 million in charges related to the exchange of our Equity Units in the prior year.

Other non-operating income (expense) of CIVs decreased \$15.6 million, to a gain of \$1.7 million, due to losses associated with an increase in fair value of the debt related to a CIV.

### **Income Tax Provision**

The provision for income taxes was \$119.4 million compared to \$118.7 million in the prior year. During fiscal

2011, the U.K. Finance Bill of 2010 was enacted, which reduced the corporate tax rate from 28% to 27% for periods beginning after April 1, 2011. The impact of the tax rate change on certain existing deferred tax liabilities resulted in a tax benefit of approximately \$8.9 million.

The effective tax rate was 32.7% compared to 36.0% in the prior year. The effective tax rate, excluding the impact of CIVs, was 32.0% and 36.7% as of March 31, 2011 and 2010, respectively. This decrease was primarily driven by the revaluation of certain deferred tax assets and liabilities as a result of the enactment of the U.K. tax rate reduction and adjustments to state tax rates impacted by apportionment changes. In addition, the current period benefited from adjustments resulting from the finalization of prior period tax positions.

Although not yet enacted, additional proposed reductions in the U.K. corporate tax rate to 26% in fiscal 2012 and 25% in fiscal 2013 are expected. Each one percentage point reduction in the U.K. corporate tax rate will result in a tax benefit of approximately \$8.9 million at the time of enactment, based on the amount of deferred tax assets and liabilities as of March 31, 2011, that have to be revalued at the new rate.

### **Supplemental Non-GAAP Financial Information**

#### ***Consolidated Statements of Income, Excluding Consolidated Investment Vehicles***

Effective with the April 1, 2010 adoption of a new financial accounting standard on consolidation, we now consolidate and separately identify certain sponsored investment vehicles, the most significant of which is a CLO. In presenting our "Consolidated Statements of Income, Excluding Consolidated Investment Vehicles," we add back the investment advisory and distribution and servicing fees that are eliminated upon the consolidation of investment vehicles and exclude the operating expenses and the impact on non-operating income (expense) and noncontrolling interests of CIVs.

We believe it is important to provide the Consolidated Statements of Income, Excluding Consolidated Investment Vehicles to present the underlying economic performance of our core asset management operations, which does not include the results of the investment funds that we manage but may not own all of the equity invested. By deconsolidating the CIVs from the Consolidated Statements of Income, the investment advisory and distribution fees earned by Legg Mason from CIVs are added back to reflect our actual revenues. Similarly the operating expenses and

the impact on non-operating income (expense) and noncontrolling interests of CIVs are removed from the GAAP basis Statements of Income since this activity does not actually belong to us. The deconsolidation of the investment vehicles does not have any impact on Net Income Attributable to Legg Mason, Inc. in any period presented. The Consolidated Statements

of Income, Excluding Consolidated Investment Vehicles are presented in addition to our GAAP basis Consolidated Statements of Income, but are not substitutes for the GAAP basis Consolidated Statements of Income and may not be comparable to Consolidated Statements of Income presented on a non-GAAP basis of other companies.

The following tables present a reconciliation of our Consolidated Statements of Income presented on a GAAP basis to our Consolidated Statements of Income, Excluding Consolidated Investment Vehicles for the years ended March 31, 2011 and 2010:

	For the Years Ended March 31,					
	2011			2010		
	GAAP Basis	CIVs	Non-GAAP Basis— Excluding CIVs	GAAP Basis	CIVs	Non-GAAP Basis— Excluding CIVs
Total operating revenues	\$2,784,317	\$4,133	\$2,788,450	\$2,634,879	\$ 2,779	\$2,637,658
Total operating expenses	2,397,509	(571)	2,396,938	2,313,696	680	2,314,376
Operating Income	386,808	4,704	391,512	321,183	2,099	323,282
Other non-operating income (expense)	(21,611)	3,680	(17,931)	8,473	(8,520)	(47)
Income (Loss) before Income Tax Provision	365,197	8,384	373,581	329,656	(6,421)	323,235
Income tax provision	119,434	—	119,434	118,676	—	118,676
Net Income (Loss)	245,763	8,384	254,147	210,980	(6,421)	204,559
Less: Net income (loss) attributable to noncontrolling interests	(8,160)	8,384	224	6,623	(6,421)	202
Net Income Attributable to Legg Mason, Inc.	\$ 253,923	\$ —	\$ 253,923	\$ 204,357	\$ —	\$ 204,357

### Adjusted Income

As supplemental information, we are providing a performance measure that is based on a methodology other than generally accepted accounting principles (“non-GAAP”) for “Adjusted Income” that management uses as a benchmark in evaluating and comparing the period-to-period operating performance of Legg Mason, Inc. and its subsidiaries.

We define “Adjusted Income” as Net Income (Loss) Attributable to Legg Mason, Inc. plus amortization and deferred taxes related to intangible assets and goodwill, and imputed interest and tax benefits on contingent convertible debt less deferred income taxes on goodwill and indefinite-life intangible asset impairment, if any. We also adjust for non-core items that are not reflective of our economic performance, such as impairment charges and the impact of tax rate adjustments on certain deferred tax liabilities related to indefinite-life intangible assets and goodwill, and net money market fund support losses (gains).

We believe that Adjusted Income provides a useful representation of our operating performance adjusted for non-cash acquisition related items and other items that facilitate comparison of our results to the results of other asset management firms that have not issued contingent convertible debt, made significant acquisitions, or engaged in money market fund support transactions. We also believe that Adjusted Income is an important metric in estimating the value of an asset management business.

Adjusted Income only considers adjustments for certain items that relate to operating performance and comparability, and therefore, is most readily reconcilable to Net Income determined under GAAP. This measure is provided in addition to Net Income, but is not a substitute for Net Income and may not be comparable to non-GAAP performance measures, including measures of adjusted earnings or adjusted income, of other companies. Further, Adjusted Income is not a liquidity measure and should not be used in place of cash flow measures determined

under GAAP. We consider Adjusted Income to be useful to investors because it is an important metric in measuring the economic performance of asset management companies, as an indicator of value, and because it facilitates comparison of our operating results with the results of other asset management firms that have not engaged in significant acquisitions, issued contingent convertible debt, or engaged in money market fund support transactions.

In calculating Adjusted Income we add the impact of the amortization of intangible assets from acquisitions, such as management contracts, to Net Income to reflect the fact that these non-cash expenses distort comparisons of our operating results with the results of other asset management firms that have not engaged in significant acquisitions. Deferred taxes on indefinite-life intangible assets and goodwill include actual tax benefits from amortization deductions that are not realized under GAAP absent an impairment charge or the disposition of the related business. Because we fully expect to realize the economic benefit of the current period tax amortization, we add this benefit to Net Income in the calculation of Adjusted Income. However, because of our net operating loss carryforward, we will receive the benefit of the current tax amortization over time. Conversely, we subtract the non-cash income tax benefits on goodwill and indefinite-life intangible asset impairment charges and U.K. tax rate adjustments on excess book basis on certain acquired

indefinite-life intangible assets that have been recognized under GAAP. We also add back imputed interest on contingent convertible debt, which is a non-cash expense, as well as the actual tax benefits on the related contingent convertible debt that are not realized under GAAP. We also add (subtract) other non-core items, such as net money market fund support losses (gains) (net of losses on the sale of the underlying structured investment vehicle ("SIV") securities, if applicable). These adjustments reflect that these items distort comparisons of our operating results to prior periods and the results of other asset management firms that have not engaged in money market fund support transactions or significant acquisitions, including any related impairments.

Should a disposition, impairment charge or other non-core item occur, its impact on Adjusted Income may distort actual changes in the operating performance or value of our firm. Also, realized losses on money market fund support transactions are reflective of changes in the operating performance and value of our firm. Accordingly, we monitor these items and their related impact, including taxes, on adjusted income to ensure that appropriate adjustments and explanations accompany such disclosures.

Although depreciation and amortization of fixed assets are non-cash expenses, we do not add these charges in calculating Adjusted Income because these charges are related to assets that will ultimately require replacement.



A reconciliation of Net Income Attributable to Legg Mason, Inc. to Adjusted Income (in thousands except per share amounts) is as follows:

	For the Years Ended March 31,	
	2011	2010
<b>Net Income Attributable to Legg Mason, Inc.</b>	<b>\$253,923</b>	\$204,357
Plus (less):		
Amortization of intangible assets	<b>22,913</b>	22,769
Deferred income taxes on intangible assets:		
Tax amortization benefit	<b>134,602</b>	136,252
U.K. tax rate adjustment	<b>(8,878)</b>	—
Imputed interest on convertible debt	<b>36,688</b>	34,445
Net money market fund support gains <sup>(1)</sup>	<b>—</b>	(16,565)
<b>Adjusted Income</b>	<b>\$439,248</b>	\$381,258
<b>Net Income per diluted share Attributable to Legg Mason, Inc. common shareholders</b>	<b>\$ 1.63</b>	\$ 1.32
Plus (less):		
Amortization of intangible assets	<b>0.15</b>	0.14
Deferred income taxes on intangible assets:		
Tax amortization benefit	<b>0.87</b>	0.88
U.K. tax rate adjustment	<b>(0.06)</b>	—
Imputed interest on convertible debt	<b>0.24</b>	0.22
Net money market fund support gains <sup>(1)</sup>	<b>—</b>	(0.11)
<b>Adjusted Income per diluted share</b>	<b>\$ 2.83</b>	\$ 2.45

(1) Net of income taxes.

### *Operating Margin, as Adjusted*

We calculate "Operating Margin, as Adjusted," by dividing (i) Operating Income, adjusted to exclude the impact on compensation expense of gains or losses on investments made to fund deferred compensation plans, the impact on compensation expense of gains or losses on seed capital investments by our affiliates under revenue sharing agreements, transition-related costs of streamlining our business model, income (loss) of CIVs, and impairment charges by (ii) our operating revenues, adjusted to add back net investment advisory fees eliminated upon consolidation of investment vehicles, less distribution and servicing expenses which we use as an approximate measure of revenues that are passed through to third parties, which we refer to as "adjusted operating revenues." The compensation items, other than transition-related costs, are removed from Operating Income in the calculation because they are offset by an equal amount in Other non-operating income (expense), and thus have no impact on Net Income. Transition-related costs and income (loss) of CIVs are removed from Operating Income in the calculation because these items are not reflective of our core asset management operations. We use adjusted operating revenues in the calculation to show the operating margin without distribution and servicing expenses, which we use to

approximate our distribution revenues that are passed through to third parties as a direct cost of selling our products, although distribution and servicing expenses may include commissions paid in connection with the launching of closed-end funds for which there is no corresponding revenue in the period. Adjusted operating revenues also include our advisory revenues we receive from CIVs that are eliminated in consolidation under GAAP.

We believe that Operating Margin, as Adjusted, is a useful measure of our performance because it provides a measure of our core business activities excluding items that have no impact on Net Income and because it indicates what our operating margin would have been without the distribution revenues that are passed through to third parties as a direct cost of selling our products, transition-related costs, and the impact of the consolidation of certain investment vehicles described above. The consolidation of these investment vehicles does not have an impact on Net Income Attributable to Legg Mason, Inc. This measure is provided in addition to our operating margin calculated under GAAP, but is not a substitute for calculations of margins under GAAP and may not be comparable to non-GAAP performance measures, including measures of adjusted margins, of other companies.

The calculation of operating margin and operating margin, as adjusted, is as follows:

	For the Years Ended March 31,	
	2011	2010
Operating Revenues, GAAP basis	<b>\$2,784,317</b>	\$2,634,879
Plus (less):		
Operating revenues eliminated upon consolidation of investment vehicles	<b>4,133</b>	2,779
Distribution and servicing expense excluding consolidated investment vehicles	<b>(712,779)</b>	(691,868)
Operating Revenues, as adjusted	<b>\$2,075,671</b>	\$1,945,790
Operating Income	<b>\$ 386,808</b>	\$ 321,183
Plus (less):		
Gains (losses) on deferred compensation and seed investments	<b>36,274</b>	79,316
Transition-related costs	<b>54,434</b>	—
Operating income and expenses of consolidated investment vehicles	<b>4,704</b>	2,099
Operating Income, as Adjusted	<b>\$ 482,220</b>	\$ 402,598
Operating margin, GAAP basis	<b>13.9%</b>	12.2%
Operating margin, as adjusted	<b>23.2</b>	20.7

## FISCAL 2010 COMPARED WITH FISCAL 2009

### Financial Overview

Net income attributable to Legg Mason, Inc. for the year ended March 31, 2010 totaled \$204.4 million, or \$1.32 per diluted share, compared to Net loss attributable to Legg Mason, Inc. of \$1.97 billion, or \$13.99 per diluted share, in the prior year. This increase was primarily due to the impact of \$1.4 billion of losses, net of income tax benefits and compensation related adjustments, related to the elimination of the exposure to SIVs in liquidity funds managed by a subsidiary in the prior fiscal year. The impact of impairment charges related to goodwill and intangible assets, primarily in our former Wealth Management division (see Note 5 of Notes to Consolidated Financial Statements), \$863.4 million, net of income tax benefits, recorded in the prior fiscal year also contributed to the increase. Adjusted income (see Supplemental Non-GAAP Financial Information) was \$381.3 million, or \$2.45 per diluted share, compared to an adjusted loss of \$1.2 billion, or \$8.47 per diluted share, in the prior year. This increase was primarily due to the impact of \$1.7 billion of net realized losses on the sale of SIV securities in the prior fiscal year. Operating margin increased to 12.2% from (19.9)% in the prior year, primarily due to the impact of impairment charges related to goodwill and intangible assets recorded in the prior fiscal year. Operating margin, as adjusted (see Supplemental Non-GAAP Financial Information) decreased to 20.7% from 23.9% in the prior year.

### Assets Under Management

The components of the changes in our AUM (in billions) for the years ended March 31 were as follows:

	2010	2009
Beginning of period	\$632.4	\$ 950.1
Investment funds, excluding liquidity funds <sup>(1)</sup>		
Subscriptions	38.8	43.7
Redemptions	(40.2)	(78.6)
Separate account flows, net	(76.5)	(109.0)
Liquidity fund flows, net	(4.1)	(15.0)
Net client cash flows	(82.0)	(158.9)
Market performance and other <sup>(2)</sup>	134.1	(157.7)
Dispositions	—	(1.1)
End of period	\$684.5	\$ 632.4

(1) Subscriptions and redemptions reflect the gross activity in the funds and include assets transferred between funds and between share classes.

(2) Includes impact of foreign exchange.

AUM at March 31, 2010 were \$685 billion, an increase of \$52 billion or 8% from March 31, 2009. The increase in AUM was attributable to market appreciation of \$134 billion, of which approximately 6% resulted from the impact of foreign currency exchange fluctuation, which was partially offset by net client outflows of \$82 billion. The majority of outflows were in fixed income with \$64 billion, or 78% of the outflows, followed by equity outflows and liquidity outflows of \$15 billion and \$3 billion, respectively. The majority of fixed income outflows were in products managed by Western Asset and

Brandywine that had experienced past investment underperformance, although their performance improved significantly during fiscal 2010. Equity

outflows were primarily experienced by products managed at ClearBridge, Batterymarch, Permal and LMCM.

### **AUM by Asset Class**

AUM by asset class (in billions) as of March 31 were as follows:

	2010	% of Total	2009	% of Total	% Change
Equity	\$173.8	25.4	\$126.9	20.1	37.0
Fixed income	364.3	53.2	357.6	56.5	1.9
Liquidity	146.4	21.4	147.9	23.4	(1.0)
Total	\$684.5	100.0	\$632.4	100.0	8.2

The component changes in our AUM by asset class (in billions) for the fiscal year ended March 31, 2010 were as follows:

	Equity	Fixed Income	Liquidity	Total
March 31, 2009	\$126.9	\$357.6	\$147.9	\$632.4
Investment funds, excluding liquidity funds				
Subscriptions	18.7	20.1	—	38.8
Redemptions	(23.4)	(16.8)	—	(40.2)
Separate account flows, net	(10.7)	(67.3)	1.5	(76.5)
Liquidity fund flows, net	—	—	(4.1)	(4.1)
Net client cash flows	(15.4)	(64.0)	(2.6)	(82.0)
Market performance and other	62.3	70.7	1.1	134.1
March 31, 2010	\$173.8	\$364.3	\$146.4	\$684.5

Average AUM by asset class (in billions) for the year ended March 31 were as follows:

	2010	% of Total	2009	% of Total	% Change
Equity	\$155.7	23.0	\$203.2	25.1	(23.4)
Fixed income	370.7	54.9	438.0	54.0	(15.4)
Liquidity	149.1	22.1	169.2	20.9	(11.9)
Total	\$675.5	100.0	\$810.4	100.0	(16.6)

### **AUM by Division**

AUM by division (in billions) as of March 31 were as follows:

	2010	% of Total	2009	% of Total	% Change
Americas	\$475.8	69.5	\$446.7	70.6	6.5
International	208.7	30.5	185.7	29.4	12.4
Total	\$684.5	100.0	\$632.4	100.0	8.2

The component changes in our AUM by division (in billions) for the year ended March 31, 2010 were as follows:

	Americas	International	Total
March 31, 2009	\$446.7	\$185.7	\$632.4
Investment funds, excluding liquidity funds			
Subscriptions	24.4	14.4	38.8
Redemptions	(26.2)	(14.0)	(40.2)
Separate account flows, net	(50.7)	(25.8)	(76.5)
Liquidity fund flows, net	(18.6)	14.5	(4.1)
Net client cash flows	(71.1)	(10.9)	(82.0)
Market performance and other	100.2	33.9	134.1
March 31, 2010	\$475.8	\$208.7	\$684.5



### Investment Performance<sup>(1)</sup>

Investment performance of our assets under management in the year ended March 31, 2010 improved compared to relevant benchmarks from the prior year.

Although the unemployment rate remains high, the U.S. economy continued to slowly show signs of recovery. A strong rebound in corporate earnings, improvements in existing home sales and consumer spending, and stabilization in the financial services industry helped to restore some level of investor confidence. However, uncertainty in the markets remained, as best evidenced by the May 6, 2010 intraday sell-off and subsequent rebound. With concerns regarding the credit quality of certain European nations, and as government stimulus initiatives continued globally, debates about inflation and deflation loomed.

In the fixed income markets, government yields continued to rise as investors grew concerned about the need to finance the growing federal deficit and demand for government bonds decreased due to investors' returning appetite for risk. Most sector spreads declined in 2009 as investors returned to riskier securities such as high-yield bonds and emerging market debt securities. Investment grade corporate bonds delivered their strongest performance on record with 2000 basis points in excess returns over treasuries in 2009.

For the 1-year period, the Treasury yield curve was historically steep as the Federal Reserve continued to keep federal funds at close to 0%. The worst performing fixed income sector was Government bonds as measured by the Barclays U.S. Government Bond returning (3.70)%, in contrast to High Yield Bonds which returned 58.21% for 2009.

The following table presents a summary of the percentage of our marketed composite assets<sup>(2)</sup> that outpaced their benchmarks as of March 31, 2010 and 2009, for the trailing 1-year, 3-year, 5-year, and 10-year periods:

	As of March 31, 2010				As of March 31, 2009			
	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year
Equity	49%	61%	72%	86%	49%	53%	58%	88%
Fixed income	88%	40%	50%	88%	31%	12%	32%	17%

The following table presents a summary of the percentage of our U.S. mutual fund assets<sup>(3)</sup> that outpaced their Lipper category as of March 31, 2010 and 2009, for the trailing 1-year, 3-year, 5-year, and 10-year periods:

	As of March 31, 2010				As of March 31, 2009			
	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year
Total long-term	62%	68%	70%	80%	43%	52%	47%	75%
Equity	51%	63%	65%	78%	47%	60%	49%	76%
Fixed income	81%	78%	83%	87%	38%	41%	45%	72%

### Revenue by Division

Operating revenues by division (in millions) for the years ended March 31 were as follows:

	2010	% of Total	2009	% of Total	% Change
Americas	\$1,864.2	70.8	\$2,290.5	68.2	(18.6)
International	770.7	29.2	1,066.9	31.8	(27.8)
Total	\$2,634.9	100.0	\$3,357.4	100.0	(21.5)

The decrease in operating revenues in the Americas division was primarily due to decreased mutual fund advisory fees on assets managed by Western Asset, LMCM, and ClearBridge, decreased separate account advisory fees on assets managed by Western Asset and ClearBridge and decreased distribution and service fee revenues from U.S. retail equity funds. The decrease in operating revenues in the International division was primarily due to decreased fund revenues at Permal.

(1) Index performance in this section includes reinvestment of dividends and capital gains.

(2) As of March 31, 2010 and 2009, 87% and 85% of our equity assets under management, respectively, in each period, and 82% and 84%, of our fixed income assets under management, respectively, were in marketed composites.

(3) Source: Lipper Inc. includes open-end, closed-end, and variable annuity funds. As of March 31, 2010 and 2009, the U.S. long-term mutual fund assets represented in the data accounted for 16% and 12%, respectively, of our total assets under management. The performance of our U.S. long-term mutual fund assets is included in the marketed composites.

## RESULTS OF OPERATIONS

### Operating Revenues

Total operating revenues for the year ended March 31, 2010 were \$2.6 billion, down 22% from \$3.4 billion in the prior year primarily as a result of a 17% decrease in average AUM. The shift in the mix of average AUM from higher fee equity assets to a greater percentage of liquidity and fixed income assets also contributed to the revenue decline.

Investment advisory fees from separate accounts decreased \$202.4 million, or 20%, to \$814.8 million. Of this decrease, \$104.3 million was the result of lower average equity assets at ClearBridge, Private Capital Management, LP ("PCM"), LMCM and Brandywine, and \$95.5 million was the result of lower average fixed income assets managed at Western Asset.

Investment advisory fees from funds decreased \$469.1 million, or 26%, to \$1.4 billion. Of this decrease, \$309.2 million was the result of lower average equity assets managed primarily at Permal, LMCM, and ClearBridge, \$73.1 million was the result of fee waivers related to liquidity funds managed by Western Asset primarily to maintain certain yields to investors, and \$66.9 million was the result of lower average liquidity assets managed at Western Asset.

Performance fees increased 310%, or \$54.0 million, to \$71.5 million during fiscal 2010, driven by fees earned on assets managed at Western Asset and Permal.

Distribution and service fees decreased 21% to \$375.3 million, primarily as a result of a decline in average mutual fund AUM and the impact of increased fee waivers related to liquidity funds managed by Western Asset.

### Operating Expenses

As a result of substantial declines in revenues during fiscal 2009 due to challenging market conditions, actions were taken to reduce our corporate cost structure. These cost-saving measures primarily included reductions in full-time employees and discretionary incentive compensation in business support functions, significant reductions in the utilization of consultants for technology projects, and substantial curtailment of promotional costs.

Operating expenses in fiscal 2010 continued to benefit from the cost reduction initiatives implemented in fiscal 2009, with many of the more significant actions

implemented in the December 2008 quarter. The discussion below for each of our operating expenses identifies the amount of variance attributable to cost savings achieved in fiscal 2010, where applicable.

Compensation and benefits decreased 2% to \$1.1 billion. This decrease was driven by a \$139.1 million decrease in revenue share-based compensation, primarily resulting from lower revenues in fiscal 2010, the impact of which was offset in part by reductions in other operating expenses at revenue share-based affiliates. The net impact of workforce reductions lowered compensation by approximately \$27.5 million. These reductions were substantially offset by an increase in deferred compensation and revenue share-based incentive obligations of \$150.3 million resulting from market gains on assets invested for deferred compensation plans and seed capital investments, which are offset by gains in other non-operating income (expense). Compensation as a percentage of operating revenues increased to 42.2% from 33.7% in the prior fiscal year primarily as a result of compensation increases related to unrealized market gains on assets invested for deferred compensation plans and investments in proprietary fund products and the impact of fixed compensation costs which do not directly vary with revenues.

Distribution and servicing expenses decreased 29% to \$691.9 million, primarily as a result of a decrease in average AUM in certain products for which we pay fees to third-party distributors and the impact of liquidity fund fee waivers that reduce amounts paid to our distributors.

Communications and technology expense decreased 13% to \$163.1 million, primarily as a result of cost savings initiatives that contributed to a \$13.6 million reduction in technology consulting fees, telecommunications and market data services. Reductions in printing costs and lower technology depreciation expense, which resulted from the full depreciation of certain assets prior to or during fiscal 2010, of \$7.7 million and \$4.5 million, respectively, also contributed to the decrease.

Occupancy expense decreased 25% to \$157.0 million, primarily due to the recognition of \$70.1 million of lease charges related to office vacancies recorded in the prior year, offset in part by a \$19.3 million charge primarily resulting from the subleasing of space in our corporate headquarters in fiscal 2010.

Amortization of intangible assets decreased 38% to \$22.8 million, primarily due to the impact of intangible asset impairments during fiscal 2009, which reduced amortization expense by \$13.5 million.

Impairment charges were \$1.3 billion in fiscal 2009. Approximately \$1.2 billion of the total impairment charges related to goodwill and intangible assets in our former Wealth Management division as a result of significant declines in the AUM and projected cash flows within that division. The remaining \$146 million related to certain acquired management contracts, as a result of a more accelerated rate of client attrition, and the impairment of a trade name.

Other expenses decreased \$14.4 million to \$167.6 million, primarily as a result of cost savings initiatives that contributed to reductions in travel and entertainment costs of \$15.6 million, and advertising costs of \$7.7 million. These decreases were partially offset by an increase of \$11.5 million in charges related to the impact of an investor settlement and trading errors.

#### **Non-Operating Income (Expense)**

Interest income decreased 87% to \$7.4 million, primarily as a result of a decline in average interest rates and lower average investment balances, which reduced interest income by \$36.2 million and \$12.9 million, respectively.

Interest expense decreased 31% to \$126.3 million, primarily as a result of the exchange of our Equity Units in August 2009, which reduced interest expense by \$36.5 million, and a \$24.6 million decrease due to the repayment of \$250 million of the outstanding borrowings under our revolving credit facility in March 2009, the repayment of our 6.75% senior notes in July 2008, the repayment of the \$550 million outstanding balance on our \$700 million term loan in January 2010, as well as lower interest rates paid on this term loan during fiscal 2010. These decreases were partially offset by an increase of \$5.0 million in amortization of debt

issuance costs, primarily related to the early repayment of our \$700 million term loan.

Due to increases in the net asset values of previously supported liquidity funds, in fiscal 2010 we reversed unrealized, non-cash losses recorded in fiscal 2009 of \$20.6 million related to liquidity fund support arrangements for our offshore funds that did not involve SIVs. During fiscal 2009, fund support losses were \$1.7 billion, primarily as a result of SIV price deterioration and our elimination of SIV exposure. See Note 19 of Notes to Consolidated Financial Statements for additional information on fund support.

Other non-operating income (expense) increased \$203.9 million to income of \$86.9 million, primarily as a result of an increase of \$133.7 million in unrealized market gains on assets invested for deferred compensation plans, which are substantially offset by corresponding compensation increases discussed above, and \$86.9 million in unrealized market gains on investments in proprietary fund products, which are partially offset by corresponding compensation increases discussed above. These increases were offset in part by the impact of \$22.0 million in charges related to the exchange of substantially all of our Equity Units in fiscal 2010.

#### **Income Tax Provision (Benefit)**

The provision for income taxes was \$118.7 million compared to a benefit of \$1.2 billion in the prior year, primarily as a result of increased earnings due to the absence of losses related to liquidity fund support and goodwill impairment charges. The effective tax rate was 36.0% compared to a benefit rate of 38.4% in the prior year. The current year rate was beneficially impacted by lower effective tax rates in foreign jurisdictions. The prior year's benefit rate was driven by the impact of the SIV-related charges with lower state tax benefits and the impact of a non-deductible portion of the goodwill impairment charge, offset by tax benefits associated with the restructuring of a foreign subsidiary.



## Supplemental Non-GAAP Financial Information

### Consolidated Statements of Income, excluding Consolidated Investment Vehicles

The following tables present a reconciliation of our Consolidated Statements of Income presented on a GAAP basis to our Consolidated Statements of Income, Excluding Consolidated Investment Vehicles for the years ended March 31, 2010 and 2009:

	For the Years Ended March 31,					
	2010		2009			
	GAAP Basis	CIVs	Non-GAAP Basis— Excluding CIVs	GAAP Basis	CIVs	Non-GAAP Basis— Excluding CIVs
Total operating revenues	\$2,634,879	\$ 2,779	\$2,637,658	\$ 3,357,367	\$ 1,232	\$ 3,358,599
Total operating expenses	2,313,696	680	2,314,376	4,026,547	(705)	4,025,842
Operating Income	321,183	2,099	323,282	(669,180)	1,937	(667,243)
Other non-operating income (expense)	8,473	(8,520)	(47)	(2,519,017)	(4,705)	(2,523,722)
Income (Loss) before Income Tax Provision	329,656	(6,421)	323,235	(3,188,197)	(2,768)	(3,190,965)
Income tax provision	118,676	—	118,676	(1,223,203)	—	(1,223,203)
Net Income (Loss)	210,980	(6,421)	204,559	(1,964,994)	(2,768)	(1,967,762)
Less: Net income (loss) attributable to noncontrolling interests	6,623	(6,421)	202	2,924	(2,768)	156
Net Income Attributable to Legg Mason, Inc.	\$ 204,357	\$ —	\$ 204,357	\$(1,967,918)	\$ —	\$(1,967,918)

### Adjusted Income

A reconciliation of Net Income Attributable to Legg Mason, Inc. to Adjusted Income (in thousands except per share amounts) is as follows:

	For the Years Ended March 31,	
	2010	2009
Net Income Attributable to Legg Mason, Inc.	\$204,357	\$(1,967,918)
Plus (less):		
Amortization of intangible assets	22,769	36,488
Deferred income taxes on intangible assets:		
Tax amortization benefit	136,252	142,494
Deferred income taxes on impairment charges	—	(444,618)
Imputed interest on convertible debt	34,445	32,340
Net money market fund support (gains) losses <sup>(1)</sup>	(16,565)	1,376,579
Impairment charges	—	1,307,970
Net loss on sale of SIV securities <sup>(1)</sup>	—	(1,674,724)
Adjusted Income	\$381,258	\$(1,191,389)
Net Income per diluted share attributable to Legg Mason, Inc. common shareholders	\$ 1.32	\$ (13.99)
Plus (less):		
Amortization of intangible assets	0.14	0.26
Deferred income taxes on intangible assets:		
Tax amortization benefit	0.88	1.01
Deferred income taxes on impairment charges	—	(3.16)
Imputed interest on convertible debt	0.22	0.23
Net money market fund support (gains) losses <sup>(1)</sup>	(0.11)	9.79
Impairment charges	—	9.30
Net loss on sale of SIV securities <sup>(1)</sup>	—	(11.91)
Adjusted income per diluted share	\$ 2.45	\$ (8.47)

(1) Includes related adjustments to operating expenses, if applicable, and income tax provision (benefit).

The increase in Adjusted Income was primarily due to the impact of net realized losses of \$1.7 billion on the sale of SIV securities in the prior fiscal year.

### *Operating Margin, as Adjusted*

	For the Years Ended March 31,	
	2010	2009
Operating Revenues, GAAP basis	\$2,634,879	\$3,357,367
Plus (less):		
Operating revenues eliminated upon consolidation of investment vehicles	2,779	1,232
Distribution and servicing expense excluding consolidated investment vehicles	(691,868)	(969,952)
Operating Revenues, as adjusted	\$1,945,790	\$2,388,647
Operating Income	\$ 321,183	\$ (669,180)
Plus (less):		
Gains (losses) on deferred compensation and seed investments	79,316	(70,950)
Impairment charges	—	1,307,970
Operating income and expenses of consolidated investment vehicles	2,099	1,937
Operating Income, as Adjusted	\$ 402,598	\$ 569,777
Operating margin, GAAP basis	12.2%	(19.9)%
Operating margin, as adjusted	20.7	23.9

### **LIQUIDITY AND CAPITAL RESOURCES**

The primary objective of our capital structure is to appropriately support our business strategies and to provide needed liquidity at all times, including maintaining required capital in certain subsidiaries. Liquidity and the access to liquidity is important to the success of our ongoing operations. Our overall funding needs and capital base are continually reviewed to determine if the capital base meets the expected needs of our businesses. We intend to continue to explore potential acquisition opportunities as a means of diversifying and strengthening our asset management business. These opportunities may from time-to-time involve acquisitions that are material in size and may require, among other things, and, subject to existing covenants, the raising of additional equity capital and/or the issuance of additional debt.

The consolidation of variable interest entities as of April 1, 2010 under new accounting guidance, as further discussed in Critical Accounting Policies, did not

impact our liquidity and capital resources. We have no rights to the benefits from, nor do we bear the risks associated with, the assets and liabilities of the CIVs, beyond our investments in and investment advisory fees generated from these vehicles, which are eliminated in consolidation. Additionally, creditors of the CIVs have no recourse to our general credit beyond the level of our investment, if any, so we do not consider these liabilities to be our obligations.

Our assets consist primarily of intangible assets, cash and cash equivalents, goodwill, investment securities, and investment advisory and related fee receivables. Our assets have been principally funded by equity capital, long-term debt and the results of operations. At March 31, 2011, our cash and cash equivalents, total assets, long-term debt and stockholders' equity were \$1.4 billion, \$8.3 billion, \$1.2 billion and \$5.8 billion, respectively. Total assets and total liabilities of the CIVs at March 31, 2011 were \$437 million and \$337 million, respectively.

The following table summarizes our consolidated statements of cash flows for the years ended March 31 (in millions):

	2011	2010	2009
Cash flows from operating activities	\$ 412.1	\$1,413.1	\$ 382.0
Cash flows used for investing activities	(44.4)	(276.7)	(1,090.9)
Cash flows (used for) from financing activities	(468.5)	(746.7)	329.2
Effect of exchange rate changes	10.8	19.5	(27.2)
Net change in cash and cash equivalents	(90.0)	409.2	(406.9)
Cash and cash equivalents, beginning of year	1,465.9	1,056.7	1,463.6
Cash and cash equivalents, end of year	\$1,375.9	\$1,465.9	\$ 1,056.7

During fiscal 2011, our cash flows from operating activities were \$412.1 million, primarily attributable to our current year net income adjusted for non-cash items. Cash outflows for investing activities during fiscal 2011 were \$44.4 million, primarily attributable to payments made for fixed assets. Cash outflows for financing activities of \$468.5 million, were driven by the repurchase of 14.6 million of our common shares for \$445 million. See Note 13 of Notes to Consolidated Financial Statements for additional information.

During fiscal 2010, cash flows from operating activities were \$1,413.1 million, of which \$1.0 billion reflects the receipt of income tax refunds resulting from net operating loss carrybacks. The remainder was attributable to net income adjusted for non-cash items. Cash outflows for investing activities during fiscal 2010 were \$276.7 million, primarily attributable to cash payments of \$180 million made in connection with the acquisition of Permal, and payments for fixed assets of \$84.1 million, principally associated with the relocation of our corporate headquarters, partially offset by fund support collateral received of \$38.9 million due to the amendment, termination and expiration of certain capital support arrangements. Cash outflows for financing activities were \$746.7 million, primarily due

to the repayment in January 2010 of the remaining \$550 million outstanding balance on our \$700 million five-year term loan, \$135.0 million of cash consideration paid in the Equity Units exchange offer and the payment of cash dividends.

During fiscal 2009, cash flows from operations were \$382.0 million, primarily attributable to revenue declines. Cash outflows for investing activities were \$1.1 billion during fiscal 2009, primarily attributable to the purchase of SIV securities from our liquidity funds, which used \$2.9 billion. These outflows were offset in part by proceeds from the sale of securities purchased under agreements to resell and SIV securities of \$1.1 billion, cash proceeds received for the sale of the implementation and overlay business of Legg Mason Private Portfolio Group ("LMPPG") of \$181 million, and the return of a portion of a contingent earn-out payment from the acquisition of PCM of \$120 million that was previously funded into escrow. Cash flows from financing activities provided \$329.2 million during fiscal 2009, primarily due to \$1.1 billion in net proceeds from the offering of Equity Units, offset in part by the repayment of \$425 million of 6.75% senior notes and a \$250 million repayment on our \$500 million unsecured revolving credit facility.

## Financing Transactions

The table below reflects our primary sources of financing (in thousands) as of March 31, 2011:

Type	Total at March 31, 2011	Amount Outstanding at March 31,		Interest Rate	Maturity
		2011	2010		
2.5% Convertible Senior Notes	\$1,250,000	\$1,087,932	\$1,051,243	2.50%	January 2015
5.6% Senior Notes from Equity Units	103,039	103,039	103,039	5.60%	June 2021
Revolving Credit Agreement	500,000	250,000	250,000	LIBOR + 2.625%	February 2013

During January 2008, we increased our capital base by \$1.25 billion through the sale of 2.5% convertible senior notes. The proceeds strengthened our balance sheet and provided additional liquidity that has been used for general corporate purposes, including the purchase of SIV securities from our liquidity funds. The senior notes bear interest at 2.5%, payable semi-annually in cash. We are accreting the carrying value to the principal amount at maturity using an imputed 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 additional interest expense for fiscal 2011 and 2010 of approximately \$36.7 million and \$34.4 million, respectively. In connection with this financing, we entered into economic hedging transactions that increase the effective conversion price of the notes. These hedging transactions had a net cost to us of \$83 million, which we paid from the proceeds of the notes. These transactions closed on January 31, 2008.

In May 2008, we issued 23 million Equity Units for \$1.15 billion, of which \$50 million was used to pay issuance costs. Each unit consists of a 5% interest in \$1,000 principal amount of 5.6% Senior Notes due June 30, 2021 and a purchase contract to purchase a varying number of shares of our common stock by June 30, 2011. The notes and purchase contracts are separate and distinct instruments, but their terms are structured to simulate a conversion of debt to equity and potentially remarketed debt approximately three years after issuance. During the September 2009 quarter, we completed an exchange offer for our Equity Units in the form of Corporate Units in order to increase our equity capital levels and reduce the amount of our outstanding debt and related interest expense. We exchanged 91% of our outstanding Corporate Units, each for 0.8881 of a share of our common stock and \$6.25 in cash per Corporate Unit, equating to 18.6 million shares of Legg Mason common stock and \$135.0 million of cash, including cash paid in lieu of fractional shares and transaction costs. In connection with this transaction, we incurred transaction costs of approximately \$22 million, of which \$15.7 million was in cash. Approximately 2.1 million Equity Units with \$103 million of 5.6% Senior Notes remain outstanding. We are in the process of evaluating our options for remarketing the Senior Notes by June 30, 2011. See Note 7 of Notes to Consolidated Financial Statements for additional information.

During November 2007, we borrowed an aggregate of \$500 million under our unsecured revolving credit facility for general corporate purposes. In March 2009, we repaid \$250 million of the outstanding borrowings under this credit facility. The facility may be prepaid at any time and contains customary covenants and default provisions. The facility was scheduled to mature on October 14, 2010; however, in fiscal 2010, the credit agreement was amended to extend the maturity date to February 11, 2013 and modify covenants, as discussed below.

In October 2005, we borrowed \$700 million through a syndicated five-year unsecured floating-rate term loan agreement to primarily fund the cash portion of the purchase price of the Citigroup transaction. During fiscal 2010, we repaid the remaining \$550 million outstanding balance of the debt.

The agreements entered into as part of our January 2008 issuance of \$1.25 billion in 2.5% convertible senior notes prevent us from incurring additional debt, with a few exceptions, if our debt to EBITDA ratio (as defined in the documents) exceeds 2.5. In order to complete the May 2008 issuance of the Equity Units, we received a waiver of the covenant under which we are prevented from issuing more than \$250 million in additional debt at any time when our debt to EBITDA ratio exceeds 2.5. Upon expiration of this waiver on June 30, 2011, we will be unable to incur any additional debt if our debt to EBITDA ratio exceeds 2.5. As of March 31, 2011, our debt to EBITDA ratio was 2.6 and thus the only new debt we could have incurred would be allowed by the covenant exceptions.

At March 31, 2011, our financial covenants under our bank agreements include: maximum net debt to EBITDA ratio of 2.5 and minimum EBITDA to interest expense ratio of 4.0. Debt is defined to include all obligations for borrowed money, excluding the debt incurred in the equity units offering and non-recourse debt, and under capital leases. Under these net debt covenants, our debt is reduced by the amount of our unrestricted cash in excess of the greater of subsidiary cash or \$375 million. EBITDA is defined as consolidated net income plus/minus tax expense, interest expense, depreciation and amortization, amortization of intangibles, any extraordinary expenses or losses, and any non-cash charges, as defined. As of March 31, 2011, our net debt to EBITDA ratio was 1.1 and EBITDA to interest expense ratio was 12.9. We have maintained compliance with our covenants at all times during fiscal 2011.



If our net income significantly declines, or if we spend our available cash, it may impact our ability to maintain compliance with these covenants. If we determine that our compliance with these covenants may be under pressure, we may elect to take a number of actions, including reducing our expenses in order to increase our EBITDA, using available cash to repay all or a portion of our \$250 million outstanding debt subject to these covenants or seeking to negotiate with our lenders to modify the terms or to restructure our debt. We anticipate that we will have available cash to repay our bank debt, should it be necessary. Using available cash to repay indebtedness would make the cash unavailable for other uses and might affect the liquidity discussions and conclusions above. Entering into any modification or restructuring of our debt would likely result in additional fees or interest payments.

Our outstanding debt is currently impacted by the ratings of two rating agencies. In the event of a downgrade by both rating agencies, the interest rate on our revolving line of credit may increase.

### **Other Transactions**

During fiscal 2010, in connection with the acquisition of Permal, we paid an aggregate of \$171 million in cash to acquire the remaining 62.5% of the outstanding preference shares. We also elected to purchase, for \$9 million, the rights of the sellers of the preference shares to receive an earnout payment of up to \$149 million in two years. As a result of this transaction, there will be no further payments for the Permal acquisition. In addition, during fiscal 2010 and 2009, we paid an aggregate amount of \$15.0 million in dividends on the preference shares. All payments for preference shares, including dividends, were recognized as additional goodwill.

During fiscal 2010, we announced a plan to terminate the exchangeable share arrangement related to the acquisition of Legg Mason Canada Inc., in accordance with its terms. In May 2010, 1.1 million shares, representing all remaining outstanding exchangeable shares, were exchanged for shares of our common stock.

During fiscal 2007, in connection with the acquisition of PCM, we paid into escrow the maximum fifth anniversary payment of \$300 million of which \$150 million remained in escrow subject to certain limited claw-back provisions until July 2009. During fiscal 2009, the contingency was settled at which time \$30 million

was released from escrow to the sellers and \$120 million was returned to us and recorded as a reduction of goodwill.

In April 2008, we completed a sale in which Citigroup Global Markets Inc., an affiliate of Citigroup, acquired a majority of the overlay and implementation business of LMPPG, including its managed account trading and technology platform. The sale produced cash proceeds of approximately \$181 million.

Certain of our asset management affiliates maintain various credit facilities for general operating purposes. See Notes 6 and 7 of Notes to Consolidated Financial Statements for additional information. Certain affiliates are also subject to the capital requirements of various regulatory agencies. All such affiliates met their respective capital adequacy requirements.

### **Liquidity Fund Support**

During fiscal 2009, we had arrangements to provide financial support to certain liquidity funds. During fiscal 2009, we purchased and subsequently sold, or reimbursed the funds for a portion of their losses incurred in selling, all outstanding securities issued by SIVs held in various liquidity funds managed by one of our affiliates, the majority of which were previously supported under these arrangements. During fiscal 2009, we also sold Canadian conduit securities purchased from one of our liquidity funds during fiscal 2008. In fiscal 2009, we provided additional support to liquidity funds that was not related to SIV securities. As of March 31, 2010 all support arrangements were terminated or expired.

During fiscal 2009, we paid \$2.9 billion for an aggregate \$3.0 billion in principal amount (plus \$24 million of accrued interest) of non-bank sponsored SIV securities from certain liquidity funds that were previously supported under various capital support agreements ("CSAs") and letters of credit ("LOCs"). Upon the purchase of these securities, the CSAs and LOCs were terminated in accordance with their terms. Collateral of \$2.0 billion was returned, which included the return of \$1.3 billion of collateral provided during fiscal 2009 to support new or amended CSAs and LOCs.

During fiscal 2009, the \$3.0 billion of purchased securities were sold along with \$355 million of securities previously supported by a total return swap ("TRS") and \$76 million of Canadian conduit securities held on our balance sheet, to third parties for \$627.3 million, net of transaction costs. The TRS terminated in

accordance with its terms upon the sale of the securities and \$209 million of collateral was returned.

During fiscal 2009, we also paid \$181.2 million to reimburse two funds for a portion of losses they incurred in selling SIV securities.

During fiscal 2010, the four remaining CSAs to provide up to \$42 million in support to two liquidity funds were terminated or expired in accordance with their terms. No amounts were drawn thereunder and \$42 million of collateral was returned.

### **Future Outlook**

We expect that over the next 12 months our operating activities will be adequate to support our operating cash needs. In addition to our ordinary operating cash needs, as described above, we anticipate other cash needs during the next 12 months. In connection with the announced plan to streamline our business model, we expect to incur transition-related costs in the range of \$115 million to \$135 million through March 2012, of which approximately 15% are non-cash charges. During fiscal 2011, \$54.4 million of these costs were accrued and substantially all of the remaining costs will be accrued in fiscal 2012. A significant portion of the accrued costs will be paid in fiscal 2012. We project that the initiative will result in annual cost savings of approximately \$130 million to \$150 million, excluding costs to achieve these savings, and expect to achieve these savings on a run rate basis by the fourth quarter of fiscal 2012. See Note 16 of Notes to Consolidated Financial Statements for information regarding transition-related costs recorded in fiscal 2011.

We currently intend to utilize our other available resources for any number of potential activities, including seed capital investments in new products, repurchase of shares of our common stock, as further discussed below, repayment of outstanding debt, payment of increased dividends, or acquisitions.

As described above, we currently project that our available cash and cash flows from operating activities will be sufficient to fund our liquidity needs. We also currently have approximately \$1.0 billion in cash in excess of our working capital requirements, a portion of which we intend to utilize to repurchase up to \$400 million of our common stock by the end of fiscal 2012, subject to market conditions and our performance, actual cash flows, and other capital needs. These repurchases will be made under the current Board of Directors authorization to repurchase up to \$1 billion of our common

stock, announced in May 2010, of which \$555 million remains unused as of March 31, 2011. Accordingly, we do not currently expect to raise additional debt or equity financing over the next 12 months. However, there can be no assurances of these expectations as our projections could prove to be incorrect, unexpected events may occur that require additional liquidity, such as an acquisition opportunity or an opportunity to refinance indebtedness, or market conditions might significantly worsen, affecting our results of operations and generation of available cash. If these events resulted in our operations and available cash being insufficient to fund liquidity needs, we would likely seek to manage our available resources by taking actions such as reducing future share repurchases, additional cost-cutting, reducing our expected expenditures on investments, selling assets (such as investment securities), repatriating earnings from foreign affiliates, or modifying arrangements with our affiliates and/or employees. Should these types of actions prove insufficient, or should a large acquisition or refinancing opportunity arise, we may seek to raise additional equity or debt.

### **Credit and Liquidity Risk**

Cash and cash equivalent deposits involve certain credit and liquidity risks. We maintain our cash and cash equivalents with a limited number of high quality financial institutions and from time to time may have concentrations with one or more of these institutions. The balances with these financial institutions and their credit quality are monitored on an ongoing basis.

### **Off-Balance Sheet Arrangements**

Off-balance sheet arrangements, as defined by the Securities and Exchange Commission ("SEC"), include certain contractual arrangements pursuant to which a company has an obligation, such as certain contingent obligations, certain guarantee contracts, retained or contingent interest in assets transferred to an unconsolidated entity, certain derivative instruments classified as equity or material variable interests in unconsolidated entities that provide financing, liquidity, market risk or credit risk support. Disclosure is required for any off-balance sheet arrangements that have, or are reasonably likely to have, a material current or future effect on our financial condition, results of operations, liquidity or capital resources. We generally do not enter into off-balance sheet arrangements, as defined, other than those described in the Contractual Obligations section that follows and Consolidation and Liquidity Fund Support discussed in Critical Accounting Policies and Notes 1, 18 and 19 of Notes to Consolidated Financial Statements.

As previously discussed, during fiscal 2009 we had various off-balance sheet arrangements to provide support to certain of our liquidity funds. These arrangements, all of which were terminated or expired prior to March 31, 2010, included letters of credit, capital support agreements and a TRS.

In January 2008, we entered into hedge and warrant transactions on the convertible notes with certain financial institution counterparties to increase the effective

conversion price of the convertible senior notes. See Note 6 of Notes to Consolidated Financial Statements.

### Contractual and Contingent Obligations

We have contractual obligations to make future payments, principally in connection with our long-term debt and non-cancelable lease agreements. See Notes 6, 7, and 9 of Notes to Consolidated Financial Statements for additional disclosures related to our commitments.

The following table sets forth these contractual obligations (in millions) by fiscal year:

	2012	2013	2014	2015	2016	Thereafter	Total
<b>Contractual Obligations</b>							
Short-term borrowings <sup>(1)</sup>	\$250.0	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 250.0
Long-term borrowings by contract maturity <sup>(2)</sup>	1.0	1.2	1.3	1,251.3	6.1	103.0	1,363.9
Interest on short-term and long-term borrowings <sup>(2)(3)</sup>	46.3	39.0	38.9	38.9	7.5	37.9	208.5
Minimum rental and service commitments	142.3	124.0	100.1	90.0	83.1	522.1	1,061.6
<b>Total Contractual Obligations<sup>(4)(5)(6)(7)</sup></b>	<b>\$439.6</b>	<b>\$164.2</b>	<b>\$140.3</b>	<b>\$1,380.2</b>	<b>\$96.7</b>	<b>\$663.0</b>	<b>\$2,884.0</b>

(1) Represents borrowing under our revolving line of credit which does not expire until February 2013. However, we may elect to repay this debt sooner if management elects to utilize a portion of our available cash for this purpose.

(2) Excludes long-term borrowings of the consolidated CLO of \$278.3 million and interest on these long-term borrowings, as applicable. The amount in thereafter is contractually due fiscal 2022, subject to potential remarketing as further described in Note 7 of Notes to Consolidated Financial Statements.

(3) Interest on floating rate short-term debt is based on rates at March 31, 2011.

(4) In connection with our restructuring plans, we no longer intend to exercise a put/purchase option on land and a building that was treated as a capital lease. The remaining rental commitment for this facility is included in minimum rental and service commitments above.

(5) The table above does not include approximately \$23.4 million in capital commitments to investment partnerships in which Legg Mason is a limited partner. These obligations will be funded, as required, through the end of the commitment periods through fiscal 2018.

(6) The table above does not include amounts for uncertain tax positions of \$60.2 million (net of the federal benefit for state tax liabilities) because the timing of any related cash outflows cannot be reliably estimated.

(7) The table above does not include amounts related to our business streamlining initiatives.

### MARKET RISK

The Company maintains an enterprise risk management program to oversee and coordinate risk management activities of Legg Mason and its subsidiaries. Under the program, certain risk activities are managed at the subsidiary level. The following describes certain aspects of our business that are sensitive to market risk.

### Revenues and Net Income

The majority of our revenue is calculated from the market value of our AUM. Accordingly, a decline in the value of securities will cause our AUM to decrease. In addition, our fixed income and liquidity AUM are subject to the impact of interest rate fluctuations, as rising interest rates may tend to reduce the market value of bonds held in various mutual fund portfolios or separately managed accounts. In the ordinary course of our business we may also reduce or waive investment management fees, or limit total expenses, on certain products or services for particular time periods to manage fund expenses, or for other reasons, and to help retain or increase managed assets. Performance

fees may be earned on certain investment advisory contracts for exceeding performance benchmarks. Declines in market values of AUM will result in reduced fee revenues and net income. We generally earn higher fees on equity assets than fees charged for fixed income and liquidity assets. Declines in market values of AUM in this asset class will disproportionately impact our revenues. In addition, under revenue sharing agreements, certain of our affiliates retain different percentages of revenues to cover their costs, including compensation. Our net income, profit margin and compensation as a percentage of operating revenues are impacted based on which affiliates generate our revenues, and a change in AUM at one subsidiary can have a dramatically different effect on our revenues and earnings than an equal change at another subsidiary.

### Trading and Non-Trading Assets

Our trading and non-trading assets are comprised of investment securities, including seed capital in sponsored mutual funds and products, limited partnerships, limited liability companies and certain other investment products.

Trading and other current investments, excluding CIVs, at March 31, 2011 and 2010 subject to risk of security price fluctuations are summarized (in thousands) below.

	2011	2010
Investment securities, excluding CIVs:		
Trading investments relating to long-term incentive compensation plans	<b>\$120,107</b>	\$118,096
Trading proprietary fund products and other investments	<b>204,063</b>	142,497
Equity method investments relating to long-term incentive compensation plans, proprietary fund products and other investments	<b>76,340</b>	74,280
Total trading and other current investments, excluding CIVs	<b>\$400,510</b>	\$334,873

Approximately \$96.0 million and \$149.8 million of trading and other current investments related to long-term incentive compensation plans as of March 31, 2011 and 2010, respectively, have offsetting liabilities such that fluctuation in the market value of these assets and the related liabilities will not have a material effect on our net income or liquidity. However, it will have an impact on our compensation expense with a corresponding offset in other non-operating income (expense). Trading and other current investments of \$72.6 million and \$17.3 million at March 31, 2011 and 2010, respectively, relate to other long-term incentive plans for which the related liabilities do not completely offset due to vesting provisions. Therefore, fluctuations in the market value of these trading investments will impact our compensation expense, non-operating income and net income.

Approximately \$231.9 million and \$167.7 million of trading and other current investments at March 31, 2011 and 2010, respectively, are investments in proprietary fund products and other investments for which fluctuations in market value will impact our non-operating income. Of these amounts, the fluctuations in market value of approximately \$30.9 million and \$33.0 million of proprietary fund products as of March 31, 2011 and 2010, respectively, have offsetting compensation expense under revenue share agreements. The fluctuations in market value of approximately \$39.8 and \$19.3 million in proprietary fund products as of March 31, 2011 and 2010, respectively, are substantially offset by gains (losses) on market hedges and therefore do not materially impact Net Income attributable to Legg Mason, Inc. Investments in proprietary fund products are not liquidated until the related fund establishes a track record, has other investors, or a decision is made to no longer pursue the strategy.

Non-trading assets, excluding CIVs, at March 31, 2011 and 2010 subject to risk of security price fluctuations are summarized (in thousands) below.

	2011	2010
Investment securities, excluding CIVs:		
Available-for-sale	<b>\$ 11,300</b>	\$ 6,957
Investments in partnerships and LLCs	<b>22,167</b>	23,049
Equity method investments in partnerships, LLCs, and other	<b>155,351</b>	100,160
Other investments	<b>270</b>	1,452
Total non-trading assets, excluding CIVs	<b>\$189,088</b>	\$131,618

Equity method investments in partnerships and LLCs at March 31, 2011 and 2010 includes approximately \$91.9 million and \$55.7 million, respectively, of investments related to our involvement with the U.S. Treasury's Public Private Investment Program ("PPIP").

Investment securities of CIVs totaled \$82.8 million and \$37.2 million as of March 31, 2011 and 2010, respectively, and investments of CIVs totaled \$312.8 million and \$13.7 million as of March 31, 2011 and 2010,

respectively. As of March 31, 2011 and 2010, we held equity investments in the CIVs of \$53.7 million and \$61.9 million, respectively. Fluctuations in the market value of investments of CIVs in excess of our equity investment will not impact Net Income Attributable to Legg Mason, Inc. However, it may have an impact on other non-operating income (expense) of CIVs with a corresponding offset in net income (loss) attributable to non-controlling interests.



Valuation of trading and non-trading investments is described below within Critical Accounting Policies under the heading "Valuation of Financial

Instruments." See Notes 1 and 15 of Notes to Consolidated Financial Statements for further discussion of derivatives.

The following is a summary of the effect of a 20% increase or decrease in the market values of our financial instruments subject to market valuation risks at March 31, 2011:

	Carrying Value	Fair Value Assuming a 20% Increase <sup>(1)</sup>	Fair Value Assuming a 20% Decrease <sup>(1)</sup>
Investment securities, excluding CIVs:			
Trading investments related to deferred compensation plans	\$120,107	\$144,128	\$ 96,086
Trading proprietary fund products and other	204,063	244,876	163,250
Equity method investments relating to deferred compensation plans, proprietary fund products and other investments	76,340	91,608	61,072
Total current investments, excluding CIVs	400,510	480,612	320,408
Net investments in CIVs	53,708	64,450	42,966
Available-for-sale investments	11,300	13,560	9,040
Investments in partnerships and LLCs	22,167	26,600	17,734
Equity method investments in partnerships, LLCs, and other	155,351	186,421	124,281
Other investments	270	324	216
Total investments subject to market risk	\$643,306	\$771,967	\$514,645

(1) Gains and losses related to certain investments in deferred compensation plans and proprietary fund products are directly offset by a corresponding adjustment to compensation expense and related liability. In addition, investments in proprietary fund products of approximately \$39.8 million have been hedged to limit market risk. As a result, a 20% increase or decrease in the unrealized market value of our financial instruments subject to market valuation risks would result in a \$70.3 million increase or decrease in our pre-tax earnings as of March 31, 2011.

### Foreign Exchange Sensitivity

We operate primarily in the United States, but provide services, earn revenues and incur expenses outside the United States. Accordingly, fluctuations in foreign exchange rates for currencies, principally in Brazil, Japan, the United Kingdom, Singapore, and Australia, may impact our comprehensive income and net income. Certain of our affiliates have entered into forward contracts to manage the impact of fluctuations in foreign exchange rates on their results of operations. We do not expect foreign currency fluctuations to have a material effect on our net income or liquidity.

### Interest Rate Risk

Exposure to interest rate changes on our outstanding debt is mitigated as a substantial portion of our debt is at fixed interest rates. At March 31, 2011 and 2010, approximately \$250.0 million and \$253.6 million, respectively, of our outstanding floating rate debt is subject to fluctuations in interest rates and will have an impact on our non-operating income and net income. As of March 31, 2011, we estimate that a 1% change in interest rates would result in a net annual change to interest expense of \$2.5 million. See Notes 6 and 7 of Notes to Consolidated Financial Statements for additional disclosures regarding debt.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Accounting policies are an integral part of the preparation of our financial statements in accordance with accounting principles generally accepted in the United States of America. Understanding these policies, therefore, is a key factor in understanding our reported results of operations and financial position. See Note 1 of Notes to Consolidated Financial Statements for a discussion of our significant accounting policies and other information. Certain critical accounting policies require us to make estimates and assumptions that affect the amounts of assets, liabilities, revenues and expenses reported in the financial statements. Due to their nature, estimates involve judgment based upon available information. Therefore, actual results or amounts could differ from estimates and the difference could have a material impact on the consolidated financial statements.

We consider the following to be our critical accounting policies that involve significant estimates or judgments.

#### Consolidation

Effective April 1, 2010, we adopted new accounting guidance, Accounting Standards Codification ("ASC") Topic 810, "Consolidation," (Statement of Financial Accounting Standards No. 167, "Amendments to

Financial Accounting Standards Board Interpretation No. 46(R)”) (“SFAS No. 167”), relating to the consolidation of variable interest entities (“VIEs”) which includes a new approach for determining who should consolidate a VIE, changes to when it is necessary to reassess who should consolidate a VIE, and changes in the assessment of which entities are VIEs. The application of the new accounting guidance has been deferred for certain investment funds, including money market funds. Investment funds that qualify for the deferral continue to be assessed for consolidation under prior guidance, Financial Accounting Standards Board Interpretation No. 46(R), “Consolidation of Variable Interest Entities—an interpretation of ARB No. 51” (“FIN 46(R)”).

In the normal course of our business, we sponsor and are the manager of various types of investment vehicles. Certain of these investment vehicles are considered to be VIEs while others are considered to be voting rights entities (“VREs”) subject to traditional consolidation concepts based on ownership rights. For our services, we are entitled to receive management fees and may be eligible, under certain circumstances, to receive additional subordinate management fees or other incentive fees. Our exposure to risk in these entities is generally limited to any equity investment we have made or are required to make and any earned but uncollected management fees. Uncollected management fees from these VIEs were not material at March 31, 2011. We have not issued any investment performance guarantees to these VIEs, VREs or their investors. Investment vehicles that are considered VREs are consolidated if we have a controlling financial interest in the investment vehicle.

#### **FIN 46(R)**

For sponsored investment funds, including money market funds, which qualify for the deferral of new accounting guidance, we determine whether we are the primary beneficiary of a VIE if we absorb a majority of the VIE’s expected losses, or receive a majority of the VIE’s expected residual returns, if any. Our determination of expected residual returns excludes gross fees paid to a decision maker. It is unlikely that we will be the primary beneficiary for VIEs created to manage assets for clients which qualify for the deferral unless our ownership interest, including interests of related parties, is substantial, unless we may earn significant performance fees from the VIE or unless we are considered to have a material implied variable interest in the VIE. In determining whether we are the primary beneficiary of

a VIE which qualifies for the deferral, we consider 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 us, related party ownership, guarantees and implied relationships. In determining the primary beneficiary, we must make assumptions and estimates about, among other things, the future performance of the underlying assets held by the VIE, including investment returns, cash flows, and credit and interest rate risks. In determining whether a VIE is significant for disclosure purposes, we consider the same factors used for determination of the primary beneficiary.

#### **SFAS No. 167**

We sponsor and are the manager for collateralized debt obligation entities (“CDOs”) and CLOs that do not qualify for the deferral, and are assessed under the new accounting guidance, as follows. We determine whether we have a variable interest in a VIE by considering if, among other things, we have the obligation to absorb losses, or the right to receive benefits, that are expected to be significant to the VIE. We consider the management fee structure, including the seniority level of our fees, the current and expected economic performance of the entity, as well as other provisions included in the governing documents that might restrict or guarantee an expected loss or residual return. If we have a significant variable interest, we determine whether we are the primary beneficiary of the VIE if we have 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 could potentially be significant to the VIE.

In evaluating whether we have the obligation to absorb losses, or the right to receive benefits, that could potentially be significant to the VIE, we consider factors regarding the design, terms, and characteristics of the investment vehicles, including the following qualitative factors: if we have involvement with the investment vehicle beyond providing management services; if we hold equity or debt interests in the investment vehicle; if we have transferred any assets to the investment vehicle; if the potential aggregate fees in future periods are insignificant relative to the potential cash flows of the investment vehicle; and if the variability of the expected fees in relation to the potential cash flows of the investment vehicle is insignificant.

Under both the new accounting guidance and prior guidance, Legg Mason must consolidate VIEs for which it is deemed to be the primary beneficiary.

See Note 18 of Notes to Consolidated Financial Statements for additional discussion of CIVs and other VIEs.

### **Revenue Recognition**

The vast majority of our revenues are calculated as a percentage of the fair value of our AUM. The underlying securities within the portfolios we manage, which are not reflected within our consolidated financial statements, are generally valued as follows: (i) with respect to securities for which market quotations are readily available, the market value of such securities; and (ii) with respect to other securities and assets, fair value as determined in good faith.

For most of our mutual funds and other pooled products, the boards of directors or similar bodies are responsible for establishing policies and procedures related to the pricing of securities. Each board of directors generally delegates the execution of the various functions related to pricing to a fund valuation committee which, in turn, may rely on information from various parties in pricing securities such as independent pricing services, the fund accounting agent, the fund manager, broker-dealers, and others (or a combination thereof). The funds have controls reasonably designed to ensure that the prices assigned to securities they hold are accurate. Management has established policies to ensure consistency in the application of revenue recognition.

As manager and advisor for separate accounts, we are generally responsible for the pricing of securities held in client accounts (or may share this responsibility with others) and have established policies to govern valuation processes similar to those discussed above for mutual funds that are reasonably designed to ensure consistency in the application of revenue recognition. Management relies extensively on the data provided by independent pricing services and the custodians in the pricing of separate account AUM. Separate account customers typically select the custodian.

Valuation processes for AUM are dependent on the nature of the assets and any contractual provisions with our clients. Equity securities under management for which market quotations are available are usually valued at the last reported sales price or official closing price on the primary market or exchange on which

they trade. Debt securities under management are usually valued at bid, or the mean between the last quoted bid and asked prices, provided by independent pricing services that are based on transactions in debt obligations, quotations from bond dealers, market transactions in comparable securities and various other relationships between securities. Short-term debt obligations are generally valued at amortized cost, which is designed to approximate fair value. The vast majority of our AUM is valued based on data from third parties such as independent pricing services, fund accounting agents, custodians and brokers. This varies slightly from time to time based upon the underlying composition of the asset class (equity, fixed income and liquidity) as well as the actual underlying securities in the portfolio within each asset class. Regardless of the valuation process or pricing source, we have established controls reasonably designed to assess the reasonableness of the prices provided. Where market prices are not readily available, or are determined not to reflect fair value, value may be determined in accordance with established valuation procedures based on, among other things, unobservable inputs. Management fees on AUM where fair values are based on unobservable inputs are not material. As of March 31, 2011, equity, fixed income and liquidity AUM values aggregated \$189.6 billion, \$356.6 billion, and \$131.4 billion, respectively.

As the vast majority of our AUM is valued by independent pricing services based upon observable market prices or inputs, we believe market risk is the most significant risk underlying valuation of our AUM. Economic events and financial market turmoil have increased market price volatility; however, the valuation of the vast majority of the securities held by our funds and in separate accounts continues to be derived from readily available market price quotations. As of March 31, 2011, less than 1% of total AUM is valued based on unobservable inputs.

### **Valuation of Financial Instruments**

Substantially all financial instruments are reflected in the financial statements at fair value or amounts that approximate fair value, except Legg Mason's long-term debt. Trading investments, Investment securities and derivative assets and liabilities included in the Consolidated Balance Sheets include forms of financial instruments. Unrealized gains and losses related to these financial instruments are reflected in net income or other comprehensive income, depending on the underlying purpose of the instrument.

For equity investments where we do not control the investee, and where we are not the primary beneficiary of a variable interest entity, but can exert significant influence over the financial and operating policies of the investee, we follow the equity method of accounting. The evaluation of whether we exert control or significant influence over the financial and operational policies of its investees requires significant judgment based on the facts and circumstances surrounding each individual investment. Factors considered in these evaluations may include investor voting or other rights, any influence we may have on the governing board of the investee, the legal rights of other investors in the entity pursuant to the fund's operating documents and the relationship between us and other investors in the entity. Substantially all of our equity method investees are investment companies which record their underlying investments at fair value. Therefore, under the equity method of accounting, our share of the investee's underlying net income or loss predominantly represents fair value adjustments in the investments held by the equity method investee. Our share of the investee's net income or loss is based on the most current information available and is recorded as a net gain (loss) on investments within non-operating income (expense).

For investments, we value equity and fixed income securities using closing market prices for listed instruments or broker or dealer price quotations, when available. Fixed income securities may also be valued using valuation models and estimates based on spreads to actively traded benchmark debt instruments with readily available market prices. We evaluate our non-trading Investment securities for "other than temporary" impairment. Impairment may exist when the fair value of an investment security has been below the adjusted cost for an extended period of time. If an "other than temporary" impairment is determined to exist, the difference between the adjusted cost of the investment security and its current fair value is recognized as a charge to earnings in the period in which the impairment is determined.

In fiscal 2009, we had in place various credit support arrangements for certain liquidity funds managed by a subsidiary that qualified as derivative transactions. The fair values of these derivative instruments were based on management's estimates of expected outcomes derived from pricing data for the underlying securities and/or detailed collateral analyses. During fiscal 2009, we purchased and subsequently sold all

supported securities issued by SIVs held in our liquidity funds, effectively eliminating our exposure to SIVs, and the various support arrangements terminated in accordance with their terms upon the purchase. As of March 31, 2009, four capital support arrangements, which supported investments in non-asset backed securities, remained outstanding. During fiscal 2010, these four remaining capital support arrangements were terminated or expired in accordance with their terms and previously recorded unrealized losses of \$20.6 million were recovered. None of these derivative transactions were designated for hedge accounting as defined in accounting guidance for derivative instruments and hedging activities, and the related gains and losses are included in Fund support in the Consolidated Statement of Operations in fiscal 2010 and 2009.

For investments in illiquid or privately-held securities for which market prices or quotations are not readily available, the determination of fair value requires us to estimate the value of the securities using a variety of methods and resources, including the most current available financial information for the investment and the industry. As of March 31, 2011 and 2010, excluding investments in CIVs, we owned approximately \$23.8 million and \$36.0 million, respectively, of financial investments that were valued on our assumptions or estimates and unobservable inputs.

At March 31, 2011 and 2010, we also have approximately \$177.5 million and \$123.2 million, respectively, of other investments, such as investment partnerships, that are included in Other noncurrent assets on the Consolidated Balance Sheets, of which approximately \$155.4 million and \$100.2 million, respectively, are accounted for under the equity method. The remainder is accounted for under the cost method. In addition, as of March 31, 2011 and 2010, we had \$76.3 million and \$74.3 million, respectively, of equity method investments that are included in Investment securities on the Consolidated Balance Sheets.

The accounting guidance for fair value measurements and disclosures defines fair value and establishes a framework for measuring fair value. The accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A fair value measurement should reflect all of



the assumptions that market participants would use in pricing the asset or liability, including assumptions about the risk inherent in a particular valuation technique, the effect of a restriction on the sale or use of an asset, and the risk of non-performance.

The accounting guidance for fair value measurements establishes a hierarchy that prioritizes the inputs for valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

Our financial instruments measured and reported at fair value are classified and disclosed in one of the following categories:

Level 1—Financial instruments for which prices are quoted in active markets, which, for us, include investments in publicly traded mutual funds with quoted market prices and equities listed in active markets.

Level 2—Financial instruments for which prices are quoted for similar assets and liabilities in active markets; prices are quoted for identical or similar assets in inactive markets; or prices are based on observable inputs, other than quoted prices, such as models or other valuation methodologies. For us, this category may include repurchase agreements, fixed income securities and certain proprietary fund products. This category also includes CLO loans and liabilities of a CIV.

Level 3—Financial instruments for which values are based on unobservable inputs, including those for which there is little or no market activity. This category includes derivative assets and liabilities related to investments in partnerships, limited liability companies, and private equity funds. Previously, this category included derivative assets related to fund support agreements and certain owned securities issued by SIVs. This category may also include certain proprietary fund products with redemption restrictions and CLO debt of a CIV.

The valuation of an asset or liability may involve inputs from more than one level of the hierarchy. The level in the fair value hierarchy within which a fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

Proprietary fund products and certain investments held by CIVs are valued at NAV determined by the fund administrator. These funds are typically invested in exchange traded investments with observable market prices. Their valuations may be classified as Level 1, Level 2 or Level 3 based on whether the fund is exchange traded, the frequency of the related NAV determinations and the impact of redemption restrictions. For investments in illiquid and privately-held securities (private equity and investment partnerships) for which market prices or quotations may not be readily available, including certain investments held by CIVs, management must estimate the value of the securities using a variety of methods and resources, including the most current available financial information for the investment and the industry to which it applies in order to determine fair value. These valuation processes for illiquid and privately-held securities inherently require management's judgment and are therefore classified in Level 3.

The fair values of CLO loans and bonds are determined based on prices from well-recognized third-party pricing services that utilize available market data and are therefore classified as Level 2. Legg Mason has established controls designed to assess the reasonableness of the prices provided. The fair value of CLO debt is valued using a discounted cash flow methodology. Inputs used to determine the expected cash flows include assumptions about forecasted default and recovery rates that a market participant would use in determining the fair value of the CLO's underlying collateral assets. Given the significance of the unobservable inputs to the fair value measurement, the CLO debt valuation is classified as Level 3.

Exchange traded options are valued using the last sale price or in the absence of a sale, the last offering price. Options traded over the counter are valued using dealer supplied valuations. Options are classified as Level 1. Futures contracts are valued at the last settlement price at the end of each day on the exchange upon which they are traded and are classified as Level 1. Index and single name credit default swaps and interest rate swaps are valued based on valuations furnished by pricing services and are classified as Level 2.

As a practical expedient, we rely on the NAVs of certain investments as their fair value. The NAVs that have been provided by investees are derived from the fair values of the underlying investments as of the reporting date.

As of March 31, 2011, approximately 3% of total assets (13% of financial assets measured at fair value) and 10% of total liabilities meet the definition of Level 3. Excluding the assets and liabilities of CIVs, approximately 2% of total assets (13% of financial assets measured at fair value) and no liabilities meet the definition of Level 3.

Any transfers between categories are measured at the beginning of the period.

See Note 3 of Notes to Consolidated Financial Statements for additional information.

## Intangible Assets and Goodwill

Balances as of March 31, 2011 are as follows:

	Americas	International	Total
Asset management contracts	\$ 48,692	\$ 4,626	\$ 53,318
Indefinite-life intangible assets	2,601,551	1,152,106	3,753,657
Trade names	7,700	62,100	69,800
Goodwill	907,079	404,573	1,311,652
	\$3,565,022	\$1,623,405	\$5,188,427

Our identifiable intangible assets consist primarily of asset management contracts, contracts to manage proprietary mutual funds or funds-of-hedge funds and trade names resulting from acquisitions. Asset management contracts are amortizable intangible assets that are capitalized at acquisition and amortized over the expected life of the contract. Contracts to manage proprietary mutual funds or funds-of-hedge funds are indefinite-life intangible assets because we assume that there is no foreseeable limit on the contract period due to the likelihood of continued renewal at little or no cost. Similarly, trade names are considered indefinite-life intangible assets because they are expected to generate cash flows indefinitely.

In allocating the purchase price of an acquisition to intangible assets, we must determine the fair value of the assets acquired. We determine fair values of intangible assets acquired based upon projected future cash flows, which take into consideration estimates and assumptions including profit margins, growth or attrition rates for acquired contracts based upon historical experience, estimated contract lives, discount rates, projected net client flows and market performance. The determination of estimated contract lives requires judgment based upon historical client turnover and attrition rates and the probability that contracts with termination provisions will be renewed. The discount rate employed is a weighted-average cost of capital that takes into consideration a premium representing the degree of risk inherent in the asset as more fully described below.

For indefinite-life intangible assets and goodwill, we project the impact of both net client flows and market

appreciation/depreciation on cash flows for the near-term (generally the first five years) based on a year-by-year assessment that considers current market conditions, our past experience, relevant publicly available statistics and projections, internal budgets, and discussions with our own market experts. Beyond five years, our projections for net client flows and market performance migrate towards relevant long-term rates in line with our own results and industry growth statistics. We believe our growth assumptions are reasonable given our consideration of multiple inputs, including internal and external sources described above. However, there continues to be uncertainty in the markets, and our assumptions are subject to change based on fluctuations in our actual results and market conditions.

Goodwill represents the residual amount of acquisition cost in excess of identified tangible and intangible assets and assumed liabilities.

Given the relative significance of our intangible assets and goodwill to our consolidated financial statements, on a quarterly basis we consider if triggering events have occurred that may indicate a significant change in fair values. Triggering events may include significant adverse changes in our business, legal or regulatory environment, loss of key personnel, significant business dispositions, or other events. If a triggering event has occurred, we perform tests, which include critical reviews of all significant assumptions, to determine if any intangible assets or goodwill are impaired. At a minimum, we perform these tests for indefinite-life intangible assets and goodwill annually at December 31.

We completed our annual impairment tests of goodwill and indefinite-life intangible assets as of December 31, 2010, and determined that there was no impairment in the value of these assets as of December 31, 2010. Further, no impairment in the value of amortizable intangible assets was recognized during the year ended March 31, 2011, as our estimates of the related future cash flows exceeded the asset carrying values. We have also determined that no triggering events have occurred as of March 31, 2011, therefore, no additional indefinite-life intangible asset and goodwill impairment testing was necessary.

### ***Amortizable Intangible Assets***

Intangible assets subject to amortization are considered for impairment at each reporting period using an undiscounted cash flow analysis. Significant assumptions used in assessing the recoverability of management contract intangible assets include projected cash flows generated by the contracts and the remaining lives of the contracts. Projected cash flows are based on fees generated by current AUM for the applicable contracts. Contracts are generally assumed to turnover evenly throughout the life of the intangible asset. The remaining life of the asset is based upon factors such as average client retention and client turnover rates. If the amortization periods are not appropriate, the expected lives are adjusted and the impact on the fair value is assessed. Actual cash flows in any one period may vary from the projected cash flows without resulting in an impairment charge because a variance in any one period must be considered in conjunction with other assumptions that impact projected cash flows.

The estimated useful lives of amortizable intangible assets currently range from 1 to 7 years with a weighted-average life of approximately 3.6 years.

### ***Indefinite-Life Intangible Assets***

For intangible assets with lives that are indeterminate or indefinite, fair value is determined from a market participant's perspective based on projected discounted cash flows. We have two primary types of indefinite-life intangible assets: proprietary fund contracts and, to a lesser extent, trade names.

We determine the fair value of our intangible assets based upon discounted projected cash flows, which take into consideration estimates of profit margins, growth rates and discount rates. An asset is determined to be impaired if the current implied fair value is less than the recorded carrying value of the asset. If an

asset is impaired, the difference between the current implied fair value and the carrying value of the asset reflected on the financial statements is recognized as an expense in the period in which the impairment is determined to be other than temporary.

Projected cash flows are based on annualized cash flows for the applicable contracts projected forward 40 years, assuming annual cash flow growth from estimated net client flows and projected market performance. Contracts that are managed and operated as a single unit, such as contracts within the same family of funds, are reviewed in aggregate and are considered interchangeable because investors can transfer between funds with limited restrictions. Similarly, cash flows generated by new funds added to the fund group are included when determining the fair value of the intangible asset. Actual cash flows in any one period may vary from the projected cash flows without resulting in an impairment charge because a variance in any one period must be considered in conjunction with other assumptions that impact projected cash flows.

The domestic mutual fund contracts acquired in the Citigroup Asset Management ("CAM") acquisition of \$2,502 million and the Permal funds-of-hedge funds contracts of \$947 million account for approximately 65% and 25%, respectively, of our indefinite-life intangible assets. For our December 31, 2010 annual impairment test, cash flows from the domestic mutual fund contracts were assumed to have annual growth rates that average approximately 8%. Cash flows on the Permal contracts were assumed to have annual growth rates that average approximately 9%. The projected cash flows from the domestic mutual fund and Permal funds were discounted at 13.2% and 14.5%, respectively. Assuming all other factors remain the same, actual results and changes in assumptions for the domestic mutual fund and Permal fund-of-hedge funds contracts would have to cause our cash flow projections over the long-term to deviate more than 20% and 25%, respectively, from previous projections or the discount rate would have to be raised to 15.0% and 17.0%, respectively, for the asset to be deemed impaired. The approximate fair values of these assets exceed their carrying values by \$628 million and \$321 million, respectively.

Trade names account for 2% of indefinite-life intangible assets and are primarily related to Permal. We tested these intangible assets using assumptions similar to those described above for indefinite-life contracts.

## **Goodwill**

Goodwill is evaluated at the reporting unit level and is considered for impairment when the carrying amount of the reporting unit exceeds the implied fair value of the reporting unit. In estimating the implied fair value of the reporting unit, we use valuation techniques based on discounted projected cash flows, similar to techniques employed in analyzing the purchase price of an acquisition target. We have defined the reporting units to be the Americas and International divisions, which are the same as our operating segments. Allocations of goodwill to our divisions for any changes in our management structure, acquisitions and dispositions are based on relative fair values of the businesses added to or sold from the divisions. See Note 17 of Notes to Consolidated Financial Statements for additional information related to business segments.

Significant assumptions used in assessing the implied fair value of the reporting unit under the discounted cash flow method include the projected cash flows generated by the reporting unit, including profit margins, expected cash flow growth rates, and the discount rate used to determine the present value of the cash flows. Cash flow growth rates consider estimates of both AUM flows and market expectations by asset class (equity, fixed income and liquidity), by investment manager and by reporting unit based upon, among other things, historical experience and expectations of future market performance from internal and external sources. The impact of both net client flows and market performance on cash flows are projected for the near-term (generally the first five years) based on a year-by-year assessment that considers current market conditions, our experience, our internal financial projections, relevant publicly available statistics and projections, and discussions with our own market experts. Actual cash flows in any one period may vary from the projected cash flows without resulting in an impairment charge because a variance in any one period must be considered in conjunction with other assumptions that impact projected cash flows.

Discount rates are based on appropriately weighted estimated costs of debt and capital using a market participant perspective. We estimate the cost of debt based on published debt rates. We estimate the cost of capital based on the Capital Asset Pricing Model, which considers the risk-free interest rate, market risk and size premiums, peer-group betas and unsystematic risk. The discount rates are also calibrated based on an assessment of relevant market values.

Goodwill in the Americas reporting unit principally originated from the acquisitions of CAM and Royce. The value of this reporting unit is based on projected net cash flows of assets managed in our U.S. mutual funds, closed end funds and other proprietary funds, in addition to separate account assets of our U.S. managers. Goodwill in the International reporting unit principally originated from the acquisitions of Permal and the international CAM businesses. For our December 31, 2010 annual impairment test, the projected cash flows were discounted at 13.2% and 14.0%, respectively, for the Americas and International divisions to determine the present value of cash flows. As of December 31, 2010, the implied fair values materially exceeded the carrying values for both the Americas and International divisions. Projected cash flows, on an aggregate basis across all asset classes in the Americas division, were assumed to have a five-year average annual growth rate of approximately 10%, with a long-term annual growth rate of approximately 8%. Projected cash flows, on an aggregate basis across all asset classes in the International division were assumed to have a five-year average annual growth rate of approximately 8%, with a long-term annual growth rate of approximately 9%. Cash flow growth for the Americas and International divisions over the next five years was based on separate factors for equity, fixed income, and liquidity products. Equity product growth projections were based on historical trends, in context with our long-term growth experience, budgets, and current market conditions. Fixed income product growth projections were based on the past experience of our primary fixed income manager, budgets, and market influences relevant to their business. Long-term growth is based on our historical experience, available historic market statistics, and estimates of future expectations. We believe our growth assumptions are reasonable given our consideration of multiple inputs, including internal and external sources described above. However, our assumptions are subject to change based on fluctuations in our actual results and market conditions. Assuming all other factors remain the same, actual results and changes in assumptions for the Americas and International reporting units would have to cause our cash flow projections for both reporting units over the long-term to deviate approximately 47% and 50%, respectively, from previous projections or the discount rate would have to increase approximately 5.9 and 7.0 percentage points, respectively, for goodwill to be considered for impairment.



As of December 31, 2010, considering relevant prices of our common shares, our market capitalization, along with a reasonable control premium, exceeds the aggregate carrying values of our reporting units.

In December 2010, we announced a realignment of our executive management team, which, among other things, will eliminate the previous separation of the Americas and International divisions into one Global Asset Management business during fiscal 2012. However, as of March 31, 2011, our internal management reporting has not changed. As a result, the Americas and International operating segments continued to be our reporting units.

### **Stock-Based Compensation**

Our stock-based compensation plans include stock options, employee stock purchase plans, market-based performance share awards, restricted stock awards and deferred compensation payable in stock. Under our stock compensation plans, we issue equity awards to directors, officers, and key employees.

In accordance with the applicable accounting guidance, compensation expense for the years ended March 31, 2011, 2010 and 2009 includes compensation cost for all non-vested share-based awards at their grant date fair value amortized over the respective vesting periods on the straight-line method. Unamortized deferred compensation is recognized as a reduction of additional paid-in capital. Also under the accounting guidance, cash flows related to income tax deductions in excess of or less than the stock-based compensation expense are classified as financing cash flows.

We granted 0.7 million, 1.5 million, and 1.5 million stock options in fiscal 2011, 2010 and 2009, respectively. For additional information on share-based compensation, see Note 12 of Notes to Consolidated Financial Statements.

We determine the fair value of each option grant using the Black-Scholes option-pricing model, except for market-based grants, for which we use a Monte Carlo option-pricing model. Both models require management to develop estimates regarding certain input variables. The inputs for the Black-Scholes model include: stock price on the date of grant, exercise price of the option, dividend yield, volatility, expected life and the risk-free interest rate, all of which except the grant date stock price and the exercise price require estimates or assumptions. We calculate the dividend yield based upon the average of the historical quarterly

dividend payments over a term equal to the vesting period of the options. We estimate volatility equally weighted between the historical prices of our stock over a period equal to the expected life of the option and the implied volatility of market listed options at the date of grant. The expected life is the estimated length of time an option will be held before it is either exercised or canceled, based upon our historical option exercise experience. The risk-free interest rate is the rate available for zero-coupon U.S. Government issues with a remaining term equal to the expected life of the options being valued. If we used different methods to estimate our variables for the Black-Scholes and Monte Carlo models, or if we used a different type of option-pricing model, the fair value of our option grants might be different.

### **Income Taxes**

We are subject to the income tax laws of the federal, state and local jurisdictions of the U.S. and numerous foreign jurisdictions in which we operate. We file income tax returns representing our filing positions with each jurisdiction. Due to the inherent complexities arising from conducting business and being taxed in a substantial number of jurisdictions, we must make certain estimates and judgments in determining our income tax provision for financial statement purposes.

These estimates and judgments are used in determining the tax basis of assets and liabilities and in the calculation of certain tax assets and liabilities that arise from differences in the timing of revenue and expense recognition for tax and financial statement purposes. Management assesses the likelihood that we will be able to realize our deferred tax assets. If it is more likely than not that the deferred tax asset will not be realized, then a valuation allowance is established with a corresponding increase to deferred tax provision.

Substantially all of our deferred tax assets relate to U.S. and United Kingdom ("U.K.") taxing jurisdictions. As of March 31, 2011, U.S. federal deferred tax assets aggregated \$683 million, realization of which is expected to require \$4.6 billion of future U.S. earnings, approximately \$129 million of which must be in the form of foreign sourced income. Deferred tax assets generated in U.S. jurisdictions resulting from net operating losses generally expire 20 years after they are generated and those resulting from foreign tax credits generally expire 10 years after they are generated. Based on estimates of future taxable income, using assumptions consistent with those used in our

goodwill impairment testing, it is more likely than not that current federal tax benefits relating to net operating losses are realizable and no valuation allowance is necessary at this time. With respect to those resulting from foreign tax credits, it is more likely than not that tax benefits relating to \$3.1 million foreign tax credits will not be realizable and a valuation allowance has been established with respect thereto. As of March 31, 2011, U.S. state deferred tax assets aggregated \$222 million. Due to limitations on net operating loss and capital loss carryforwards and, taking into consideration certain state tax planning strategies, a valuation allowance has been established for the state capital loss and net operating loss benefits in certain jurisdictions in the amount of \$0.7 million for fiscal 2011. Due to the uncertainty of future state apportionment factors and future effective state tax rates, the value of state net operating loss benefits ultimately realized may vary. As of March 31, 2011, U.K. deferred tax assets, net of valuation allowances, are not material. An additional valuation allowance was recorded on \$3.0 million of foreign deferred tax assets relating to various jurisdictions, principally relating to foreign currency translation adjustments recorded in equity. To the extent our analysis of the realization of deferred tax assets relies on deferred tax liabilities, we have considered the timing, nature and jurisdiction of reversals, as well as, future increases relating to the tax amortization of goodwill and indefinite-life intangible assets. While tax planning may enhance our positions, the realization of current tax benefits is not dependent on any significant tax strategies.

In the event we determine all or any portion of our deferred tax assets that are not already subject to a valuation allowance are not realizable, we will be required to establish a valuation allowance by a charge to the income tax provision in the period in which that determination is made. Depending on the facts and circumstances, the charge could be material to our earnings.

The calculation of our tax liabilities involves uncertainties in the application of complex tax regulations. We recognize liabilities for anticipated tax uncertainties in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, additional taxes will be due.

#### **RECENT ACCOUNTING DEVELOPMENTS**

See discussion of Recent Accounting Developments in Note 1 of Notes to Consolidated Financial Statements.

#### **FORWARD-LOOKING STATEMENTS**

We have made in this 2011 Annual Report, and from time to time may otherwise make in our public filings, press releases and statements by our management, "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, including information relating to anticipated growth in revenues, margins or earnings per share, anticipated changes in our business or in the amount of our client AUM, anticipated future performance of our business, including expected earnings per share in future periods, anticipated future investment performance of our affiliates, our expected future net client cash flows, anticipated expense levels, changes in expenses, the expected effects of acquisitions and expectations regarding financial market conditions. The words or phrases "can be," "may be," "expects," "may affect," "may depend," "believes," "estimate," "project," "anticipate" and similar words and phrases are intended to identify such forward-looking statements. Such forward-looking statements are subject to various known and unknown risks and uncertainties and we caution readers that any forward-looking information provided by or on behalf of Legg Mason is not a guarantee of future performance.

Actual results may differ materially from those in forward-looking information as a result of various factors, some of which are beyond our control, including but not limited to those discussed below and those discussed under the heading "Risk Factors" and elsewhere in our Annual Report on Form 10-K and our other public filings, press releases and statements by our management. Due to such risks, uncertainties and other factors, we caution each person receiving such forward-looking information not to place undue reliance on such statements. Further, such forward-looking statements speak only as of the date on which such statements are made, and we undertake no obligations to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events.

Our future revenues may fluctuate due to numerous factors, such as: the total value and composition of AUM; the mix of our AUM among our affiliates; the volatility and general level of securities prices and interest rates; the relative investment performance of company-sponsored investment funds and other asset

management products compared with competing offerings and market indices; investor sentiment and confidence; general economic conditions; our ability to maintain investment management and administrative fees at current levels; competitive conditions in our business; the ability to attract and retain key personnel and the effects of acquisitions, including prior acquisitions. Our future operating results are also dependent upon the level of operating expenses, which are subject to fluctuation for the following or other reasons: variations in the level of compensation expense incurred as a result of changes in the number of total employees, competitive factors, changes in the percentages of revenues paid as compensation or other reasons; variations in expenses and capital costs, including depreciation, amortization and other non-cash charges incurred by us to maintain our administrative infrastructure; unanticipated costs that may be incurred by Legg Mason from time to time to protect client goodwill, to otherwise support

investment products or in connection with litigation or regulatory proceedings; and the effects of acquisitions and dispositions.

Our business is also subject to substantial governmental regulation and changes in legal, regulatory, accounting, tax and compliance requirements that may have a substantial effect on our business and results of operations.

#### **EFFECTS OF INFLATION**

The rate of inflation can directly affect various expenses, including employee compensation, communications and technology and occupancy, which may not be readily recoverable in charges for services provided by us. Further, to the extent inflation adversely affects the securities markets, it may impact revenues and recorded intangible asset and goodwill values. See discussion of “Market Risks—Revenues and Net Income” and “Critical Accounting Policies—Intangible Assets and Goodwill” previously discussed.

# Report of Management on Internal Control over Financial Reporting

The management of Legg Mason, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting.

Legg Mason's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Legg Mason's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of Legg Mason; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of Legg Mason are being made only in accordance with authorizations of management and directors of Legg Mason; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of Legg Mason's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of Legg Mason's internal control over financial reporting as of March 31, 2011, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control—Integrated Framework*. Based on that assessment, management concluded that, as of March 31, 2011, Legg Mason's internal control over financial reporting is effective based on the criteria established in the COSO framework.

The effectiveness of Legg Mason's internal control over financial reporting as of March 31, 2011, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report appearing herein, which expresses an unqualified opinion on the effectiveness of Legg Mason's internal control over financial reporting as of March 31, 2011.



Mark R. Fetting  
Chairman, President and Chief Executive Officer



Peter H. Nachtwey  
Chief Financial Officer and Senior Executive Vice President



# Report of Independent Registered Public Accounting Firm

To the Board of Directors  
and Stockholders of Legg Mason, Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income (loss), comprehensive income (loss), changes in stockholders' equity and cash flows present fairly, in all material respects, the financial position of Legg Mason, Inc. and its subsidiaries at March 31, 2011 and March 31, 2010, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2011 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of March 31, 2011, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1 to the consolidated financial statements, in 2011 the Company adopted new accounting guidance related to the consolidation of variable interest entities.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.



Baltimore, Maryland  
May 27, 2011

# Consolidated Balance Sheets

(Dollars in thousands)

	March 31,	
	2011	2010
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	<b>\$1,375,918</b>	\$1,465,888
Cash and cash equivalents of consolidated investment vehicles	<b>37,153</b>	42,387
Restricted cash	<b>9,253</b>	2,185
Receivables:		
Investment advisory and related fees	<b>366,571</b>	349,245
Other	<b>29,466</b>	211,453
Investment securities	<b>400,510</b>	334,873
Investment securities of consolidated investment vehicles	<b>82,829</b>	37,187
Deferred income taxes	<b>82,174</b>	58,037
Other	<b>62,682</b>	57,891
Total current assets	<b>2,446,556</b>	2,559,146
Fixed assets, net	<b>286,705</b>	361,819
Intangible assets, net	<b>3,876,775</b>	3,902,222
Goodwill	<b>1,311,652</b>	1,315,296
Investments of consolidated investment vehicles	<b>312,765</b>	13,692
Deferred income taxes	<b>232,394</b>	280,474
Other	<b>240,909</b>	189,983
<b>Total Assets</b>	<b>\$8,707,756</b>	\$8,622,632
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
Current Liabilities		
Accrued compensation	<b>\$ 368,164</b>	\$ 288,856
Accounts payable and accrued expenses	<b>207,870</b>	399,613
Short-term borrowings	<b>250,000</b>	250,000
Current portion of long-term debt	<b>792</b>	5,154
Other	<b>87,393</b>	109,692
Other current liabilities of consolidated investment vehicles	<b>54,753</b>	961
Total current liabilities	<b>968,972</b>	1,054,276
Deferred compensation	<b>92,487</b>	137,312
Deferred income taxes	<b>266,193</b>	270,578
Other	<b>93,612</b>	123,985
Long-term debt	<b>1,201,076</b>	1,165,180
Long-term debt of consolidated investment vehicles	<b>278,320</b>	—
<b>Total Liabilities</b>	<b>2,900,660</b>	2,751,331
<b>Commitments and Contingencies (Note 9)</b>		
<b>Redeemable Noncontrolling Interests</b>	<b>36,712</b>	29,577
<b>Stockholders' Equity</b>		
Common stock, par value \$.10; authorized 500,000,000 shares; issued 150,218,810 shares in 2011 and 161,438,993 shares in 2010	<b>15,022</b>	16,144
Shares exchangeable into common stock	<b>—</b>	2,760
Additional paid-in capital	<b>4,111,095</b>	4,447,612
Employee stock trust	<b>(34,466)</b>	(33,095)
Deferred compensation employee stock trust	<b>34,466</b>	33,095
Retained earnings	<b>1,539,984</b>	1,316,981
Appropriated retained earnings of consolidated investment vehicles	<b>10,922</b>	—
Accumulated other comprehensive income, net	<b>93,361</b>	58,227
<b>Total Stockholders' Equity</b>	<b>5,770,384</b>	5,841,724
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$8,707,756</b>	\$8,622,632

See notes to consolidated financial statements.

# Consolidated Statements of Income (Loss)

(Dollars in thousands, except per share amounts)

	Years Ended March 31,		
	2011	2010	2009
<b>OPERATING REVENUES</b>			
Investment advisory fees			
Separate accounts	\$ 815,633	\$ 814,824	\$ 1,017,195
Funds	1,486,615	1,367,297	1,836,350
Performance fees	96,661	71,452	17,429
Distribution and service fees	379,161	375,333	475,003
Other	6,247	5,973	11,390
Total operating revenues	2,784,317	2,634,879	3,357,367
<b>OPERATING EXPENSES</b>			
Compensation and benefits	1,140,305	1,111,298	1,132,216
Transition-related compensation	45,048	—	—
Total compensation and benefits	1,185,353	1,111,298	1,132,216
Distribution and servicing	712,839	691,931	969,964
Communications and technology	161,969	163,098	188,312
Occupancy	137,861	156,967	209,537
Amortization of intangible assets	22,913	22,769	36,488
Impairment of goodwill and intangible assets	—	—	1,307,970
Other	176,574	167,633	182,060
Total operating expenses	2,397,509	2,313,696	4,026,547
<b>OPERATING INCOME (LOSS)</b>	<b>386,808</b>	<b>321,183</b>	<b>(669,180)</b>
<b>OTHER NON-OPERATING INCOME (EXPENSE)</b>			
Interest income	9,246	7,354	56,272
Interest expense	(92,157)	(126,273)	(182,805)
Fund support	—	23,171	(2,283,236)
Other	59,596	86,892	(117,044)
Other non-operating income of consolidated investment vehicles, net	1,704	17,329	7,796
Total other non-operating income (expense)	(21,611)	8,473	(2,519,017)
<b>INCOME (LOSS) BEFORE INCOME TAX PROVISION (BENEFIT)</b>	<b>365,197</b>	<b>329,656</b>	<b>(3,188,197)</b>
Income tax provision (benefit)	119,434	118,676	(1,223,203)
<b>NET INCOME (LOSS)</b>	<b>245,763</b>	<b>210,980</b>	<b>(1,964,994)</b>
Less: Net income (loss) attributable to noncontrolling interests	(8,160)	6,623	2,924
<b>NET INCOME (LOSS) ATTRIBUTABLE TO LEGG MASON, INC.</b>	<b>\$ 253,923</b>	<b>\$ 204,357</b>	<b>\$(1,967,918)</b>
<b>NET INCOME (LOSS) PER SHARE ATTRIBUTABLE TO LEGG MASON, INC. COMMON SHAREHOLDERS</b>			
Basic	\$ 1.63	\$ 1.33	\$ (13.99)
Diluted	\$ 1.63	\$ 1.32	\$ (13.99)

See notes to consolidated financial statements.

# Consolidated Statements of Changes in Stockholders' Equity

(Dollars in thousands)

	Years Ended March 31,		
	2011	2010	2009
<b>COMMON STOCK</b>			
Beginning balance	\$ 16,144	\$ 14,185	\$ 13,856
Stock options and other stock-based compensation	64	8	109
Deferred compensation employee stock trust	7	13	16
Deferred compensation, net	152	66	92
Exchangeable shares	110	12	76
Equity Units exchanged	—	1,860	—
Shares repurchased and retired	(1,455)	—	—
Preferred share conversions	—	—	36
Ending balance	15,022	16,144	14,185
<b>SHARES EXCHANGEABLE INTO COMMON STOCK</b>			
Beginning balance	2,760	3,069	4,982
Exchanges	(2,760)	(309)	(1,913)
Ending balance	—	2,760	3,069
<b>ADDITIONAL PAID-IN CAPITAL</b>			
Beginning balance	4,447,612	3,452,530	3,446,559
Stock options and other stock-based compensation	31,674	18,758	37,988
Deferred compensation employee stock trust	2,673	3,156	6,505
Deferred compensation, net	34,619	29,056	33,107
Convertible debt	—	—	(73,430)
Exchangeable shares	2,650	297	1,837
Equity Units exchanged	35,877	943,815	—
Shares repurchased and retired	(444,010)	—	—
Preferred share conversions	—	—	(36)
Ending balance	4,111,095	4,447,612	3,452,530
<b>EMPLOYEE STOCK TRUST</b>			
Beginning balance	(33,095)	(35,094)	(29,307)
Shares issued to plans	(2,136)	(2,938)	(5,787)
Distributions and forfeitures	765	4,937	—
Ending balance	(34,466)	(33,095)	(35,094)
<b>DEFERRED COMPENSATION EMPLOYEE STOCK TRUST</b>			
Beginning balance	33,095	35,094	29,307
Shares issued to plans	2,136	2,938	5,787
Distributions and forfeitures	(765)	(4,937)	—
Ending balance	34,466	33,095	35,094
<b>RETAINED EARNINGS</b>			
Beginning balance	1,316,981	1,131,625	3,236,314
Net income (loss) attributable to Legg Mason, Inc.	253,923	204,357	(1,967,918)
Dividends declared	(30,920)	(19,001)	(136,771)
Ending balance	1,539,984	1,316,981	1,131,625
<b>APPROPRIATED RETAINED EARNINGS OF CONSOLIDATED INVESTMENT VEHICLES</b>			
Beginning balance	—	—	—
Cumulative effect of change in accounting principle	24,666	—	—
Net loss reclassified to Appropriated retained earnings	(13,744)	—	—
Ending balance	10,922	—	—
<b>ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS), NET</b>			
Beginning balance	58,227	(2,784)	82,930
Realized and unrealized holding gains (losses) on investment securities, net of tax	(25)	(18)	61
Unrealized and realized gains on cash flow hedge, net of tax	—	—	938
Foreign currency translation adjustment	35,159	61,029	(86,713)
Ending balance	93,361	58,227	(2,784)
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>\$5,770,384</b>	<b>\$5,841,724</b>	<b>\$4,598,625</b>

See notes to consolidated financial statements.



# Consolidated Statements of Comprehensive Income (Loss)

(Dollars in thousands)

	Years Ended March 31,		
	2011	2010	2009
<b>NET INCOME (LOSS)</b>	<b>\$245,763</b>	\$210,980	\$(1,964,994)
Other comprehensive income:			
Foreign currency translation adjustment	<b>35,159</b>	61,029	(86,713)
Unrealized gains (losses) on investment securities:			
Unrealized holding gains (losses) net of tax provision (benefit) of \$(22), \$(9) and \$9, respectively	<b>(33)</b>	(13)	13
Reclassification adjustment for (gains) losses included in net income	<b>8</b>	(5)	48
Net unrealized gains (losses) on investment securities	<b>(25)</b>	(18)	61
Unrealized and realized gains (losses) on cash flow hedge, net of tax provision of \$666	<b>—</b>	—	938
Total other comprehensive income (loss)	<b>35,134</b>	61,011	(85,714)
<b>COMPREHENSIVE INCOME (LOSS)</b>	<b>280,897</b>	271,991	(2,050,708)
Less: Comprehensive income attributable to noncontrolling interests	<b>(8,160)</b>	6,623	2,924
<b>COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO LEGG MASON, INC.</b>	<b>\$289,057</b>	\$265,368	\$(2,053,632)

See notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

(Dollars in thousands)

	Years Ended March 31,		
	2011	2010	2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income (loss)	\$ 245,763	\$ 210,980	\$(1,964,994)
Loss on Equity Unit exchange	—	22,040	—
Realized loss on sale of SIV securities	—	—	2,257,217
Adjustments to reconcile Net Income to net cash provided by operations:			
Depreciation and amortization	102,748	114,078	138,445
Imputed interest for 2.5% convertible senior notes	36,688	34,445	32,340
Accretion and amortization of securities discounts and premiums, net	4,539	13,387	7,177
Stock-based compensation	56,245	46,578	56,993
Net (gains) losses on investments	(58,851)	(103,457)	114,412
Net (gains) losses of consolidated investment vehicles	3,959	(17,359)	(7,615)
Unrealized (gains) losses on fund support	—	(22,115)	25,996
Deferred income taxes	80,272	113,947	(817,477)
Impairment of goodwill and intangible assets	—	—	1,307,970
Other	5,393	2,808	17,918
Decrease (increase) in assets excluding acquisitions:			
Investment advisory and related fees receivable	(13,794)	(53,402)	227,137
Net (purchases) sales of trading and other current investments	(55,540)	52,288	(58,867)
Refundable income taxes	—	992,548	—
Other receivables	1,962	177,667	(626,392)
Other assets	(20,923)	(50,082)	492,597
Increase (decrease) in liabilities excluding acquisitions:			
Accrued compensation	75,970	(89,800)	(234,817)
Deferred compensation	(44,825)	32,197	(44,838)
Accounts payable and accrued expenses	(251)	2,686	(93,214)
Other liabilities	(49,954)	(86,484)	(362,349)
Net increase in operating assets and liabilities of consolidated investment vehicles, including cash	42,739	20,213	(85,579)
<b>CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>412,140</b>	<b>1,413,163</b>	<b>382,060</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Payments for fixed assets	(32,904)	(84,117)	(130,950)
Payments for business acquisitions-related costs	—	(11,092)	(7,524)
Contractual acquisition earnout settlements (payments)	—	(179,804)	120,000
Proceeds from sale of assets	—	150	181,147
Fund Support:			
Restricted cash, net (principally collateral)	—	38,890	801,793
Payments under liquidity fund support arrangements	—	—	(305,933)
Proceeds from sale of SIV securities	—	—	513,855
Purchases of SIV securities, net of distributions	—	—	(2,868,815)
Net (increase) decrease in securities purchased under agreements to resell	—	—	604,642
Purchases of investment securities	(8,430)	(55,507)	(1,293)
Proceeds from sales and maturities of investment securities	9,077	14,792	2,172
Purchases of investments by consolidated investment vehicles	(173,261)	—	—
Proceeds from sales and maturities of investments by consolidated investment vehicles	161,047	—	—
<b>CASH USED FOR INVESTING ACTIVITIES</b>	<b>\$ (44,471)</b>	<b>\$ (276,688)</b>	<b>\$(1,090,906)</b>

# Consolidated Statements of Cash Flows (Continued)

(Dollars in thousands)

	Years Ended March 31,		
	2011	2010	2009
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Net decrease in short-term borrowings	\$ —	\$ —	\$ (250,000)
Proceeds from issuance of long-term debt, net	—	—	1,089,463
Debt issue costs	—	(3,056)	—
Third-party distribution financing, net	(1,639)	(2,428)	(4,814)
Repayment of principal on long-term debt	(3,515)	(554,913)	(429,608)
Payment on Equity Unit exchange	—	(135,015)	—
Issuance of common stock	14,440	4,999	31,983
Repurchase of common stock	(445,465)	—	—
Dividends paid	(26,813)	(48,241)	(135,878)
Net repayment by consolidated investment vehicles	(7,025)	—	—
Net (redemptions/distributions paid)/subscriptions received from noncontrolling interest holders	1,551	(8,066)	28,004
<b>CASH (USED FOR) PROVIDED BY FINANCING ACTIVITIES</b>	<b>(468,466)</b>	<b>(746,720)</b>	<b>329,150</b>
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH</b>	<b>10,827</b>	<b>19,481</b>	<b>(27,206)</b>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(89,970)</b>	<b>409,236</b>	<b>(406,902)</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<b>1,465,888</b>	<b>1,056,652</b>	<b>1,463,554</b>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<b>\$1,375,918</b>	<b>\$1,465,888</b>	<b>\$1,056,652</b>
<b>SUPPLEMENTARY DISCLOSURE</b>			
Cash paid (received) for:			
Income taxes (net of payments in 2010 of \$60,747)	\$ 39,524	\$ (994,823)	\$ 156,129
Interest	46,620	73,909	158,499

See notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

(Amounts in thousands, except per share amounts or unless otherwise noted)

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Basis of Presentation

Legg Mason, Inc. (“Parent”) and its subsidiaries (collectively, “Legg Mason”) are principally engaged in providing asset management and related financial services to individuals, institutions, corporations and municipalities.

The consolidated financial statements include the accounts of the Parent and its subsidiaries in which it has a controlling financial interest. Generally, an entity is considered to have a controlling financial interest when it owns a majority of the voting interest in an entity. Legg Mason is also required to consolidate any variable interest entity (“VIE”) in which it is considered to be the primary beneficiary. See Note 18 for a further discussion of VIEs. All material intercompany balances and transactions have been eliminated.

Certain amounts in prior period financial statements have been reclassified to conform to the current period presentation, including amounts associated with certain consolidated investment vehicles (“CIVs”). See Consolidation below and Note 18 for additional information related to CIVs.

Unless otherwise noted, all per share amounts include common shares of Legg Mason, shares issued in connection with the acquisition of Legg Mason Canada Inc., which were exchangeable into common shares of Legg Mason on a one-for-one basis at any time. In May 2010, all outstanding exchangeable shares were exchanged for shares of Legg Mason common stock.

All references to fiscal 2011, 2010 or 2009 refer to Legg Mason’s fiscal year ended March 31 of that year.

### Use of Estimates

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, which require management to make assumptions and estimates that affect the amounts reported in the financial statements and accompanying notes, including revenue recognition, valuation of financial instruments, intangible assets and goodwill, stock-based compensation, income taxes, and consolidation. Management believes that the estimates used are reasonable, although actual amounts could differ from the estimates and the differences could have a material impact on the consolidated financial statements.

### Consolidation

Effective April 1, 2010, Legg Mason adopted new accounting guidance, Accounting Standards Codification (“ASC”) Topic 810, “Consolidation,” (Statement of Financial Accounting Standards No. 167, “Amendments to Financial Accounting Standards Board Interpretation No. 46(R)”) (“SFAS No. 167”), relating to the consolidation of VIEs, which includes a new approach for determining who should consolidate a VIE, changes to when it is necessary to reassess who should consolidate a VIE, and changes in the assessment of which entities are VIEs. The application of the new accounting guidance has been deferred for certain investment funds, including money market funds. Investment funds that qualify for the deferral continue to be assessed for consolidation under prior guidance, ASC Topic 810, “Consolidation,” (Financial Accounting Standards Board Interpretation No. 46(R), “Consolidation of Variable Interest Entities—an interpretation of ARB No. 51”) (“FIN 46(R)”).

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 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 did not sell or transfer assets to any of the VIEs or VREs. 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. Uncollected management fees from these VIEs were not material at March 31, 2011 and 2010. Legg Mason has not issued any investment performance guarantees to these VIEs, VREs or their investors. Investment vehicles that are considered VREs are consolidated if Legg Mason has a controlling financial interest in the investment vehicle.

### FIN 46(R)

For sponsored investment funds, including money market funds, which qualify for the deferral of the new accounting guidance, 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. It is unlikely that



Legg Mason will be the primary beneficiary for VIEs created to manage assets for clients which qualify for the deferral unless Legg Mason's ownership interest in the VIE, including interests of related parties, is substantial, unless Legg Mason may earn significant performance fees from the VIE or unless Legg Mason is considered to have a material implied variable interest. In determining whether it is the primary beneficiary of a VIE which qualifies for the deferral, 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. In determining the primary beneficiary, Legg Mason must make assumptions and estimates about, among other things, the future performance of the underlying assets held by the VIE, including investment returns, cash flows, and credit and interest rate risks. In determining whether a VIE is significant for disclosure purposes, Legg Mason considers the same factors used for determination of the primary beneficiary.

#### **SFAS No. 167**

Legg Mason sponsors and is the manager for collateralized debt obligation entities ("CDOs") and collateralized loan obligations ("CLOs") that do not qualify for the deferral, and are assessed under the new accounting guidance, as follows. Legg Mason determines whether it has a variable interest in a VIE by considering if, among other things, it has the obligation to absorb losses, or the right to receive benefits, that are expected to be significant to the VIE. Legg Mason also considers the management fee structure, including the seniority level of its fees, the current and expected economic performance of the entity, as well as other provisions included in the governing documents that might restrict or guarantee an expected loss or residual return. 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.

In evaluating whether it has the obligation to absorb losses, or the right to receive benefits, that potentially could be significant to the VIE, Legg Mason considers factors regarding the design, terms, and characteristics of the investment vehicles, including, but not limited to, the following qualitative factors: if Legg Mason

has involvement with the investment vehicle beyond providing management services; if Legg Mason holds equity or debt interests in the investment vehicle; if Legg Mason has transferred any assets to the investment vehicle; if the potential aggregate fees in future periods are insignificant relative to the potential cash flows of the investment vehicle; and if the variability of the expected fees in relation to the potential cash flows of the investment vehicle is insignificant.

Under both the new accounting guidance and prior guidance, Legg Mason must consolidate VIEs for which it is deemed to be the primary beneficiary. Under the new accounting guidance, Legg Mason consolidated a CLO that was not previously consolidated. As of March 31, 2011, Legg Mason's Consolidated Balance Sheet reflects \$314,617 in assets and \$278,320 in debt issued by the CLO, despite the fact that the assets cannot be used by Legg Mason, nor is Legg Mason obligated for the debt. The adoption had no impact on Net Income Attributable to Legg Mason, Inc.'s common shareholders. In addition, Legg Mason's Consolidated Cash Flow Statement for the year ended March 31, 2011 reflects the cash flows of this CLO. In accordance with the new accounting guidance, prior periods have not been restated. See Note 18 for additional information related to the application of the amended VIE consolidation model and the required disclosures.

#### **Cash and Cash Equivalents**

Cash equivalents are highly liquid investments with original maturities of 90 days or less.

#### **Restricted Cash**

Restricted cash primarily represents cash collateral required for market hedge arrangements. This cash is not available to Legg Mason for general corporate use.

#### **Financial Instruments**

Substantially all financial instruments are reflected in the financial statements at fair value or amounts that approximate fair value, except Legg Mason's long-term debt.

For equity investments where Legg Mason does not control the investee, and where it is not the primary beneficiary of a variable interest entity, but can exert significant influence over the financial and operating policies of the investee, Legg Mason follows the equity method of accounting. The evaluation of whether Legg Mason can exert control or significant influence over the financial and operational policies of its investees requires significant judgment based

on the facts and circumstances surrounding each individual investment. Factors considered in these evaluations may include investor voting or other rights, any influence we may have on the governing board of the investee, the legal rights of other investors in the entity pursuant to the fund's operating documents and the relationship between Legg Mason and other investors in the entity. Substantially all of Legg Mason's equity method investees are investment companies which record their underlying investments at fair value. Therefore, under the equity method of accounting, Legg Mason's share of the investee's underlying net income or loss predominantly represents fair value adjustments in the investments held by the equity method investee. Legg Mason's share of the investee's net income or loss is based on the most current information available and is recorded as a net gain (loss) on investments within non-operating income (expense). A significant portion of earnings (losses) attributable to Legg Mason's equity method investments have offsetting compensation expense adjustments under revenue sharing agreements, therefore, fluctuations in the market value of these investments will not have a material impact on Net Income Attributable to Legg Mason, Inc.

Legg Mason also holds debt and marketable equity investments which are classified as available-for-sale, held-to-maturity or trading. Debt and marketable equity securities classified as available-for-sale are reported at fair value and resulting unrealized gains and losses are reflected in stockholders' equity, non-controlling interests, and comprehensive income, net of applicable income taxes. Debt securities, for which there is positive intent and ability to hold to maturity, are classified as held-to-maturity and are recorded at amortized cost. Amortization of discount or premium is recorded under the interest method and is included in interest income. Certain investment securities, including those held by CIVs, are classified as trading securities. These investments are recorded at fair value and unrealized gains and losses are included in current period earnings. Realized gains and losses for all investments are included in current period earnings.

Equity and fixed income securities classified as trading or available-for-sale are valued using closing market prices for listed instruments or broker or dealer price quotations, when available. Fixed income securities may also be valued using valuation models and estimates based on spreads to actively traded benchmark debt instruments with readily available market prices.

Legg Mason evaluates its non-trading investment securities for "other than temporary" impairment. Impairment may exist when the fair value of an investment security has been below the adjusted cost for an extended period of time. If an "other than temporary" impairment is determined to exist, the amount of impairment that relates to credit losses is recognized as a charge to income. As of March 31, 2011, 2010 and 2009, the amount of temporary unrealized losses for investment securities not recognized in income was not material.

For investments in illiquid or privately-held securities for which market prices or quotations may not be readily available, including certain investments held by CIVs, management estimates the value of the securities using a variety of methods and resources, including the most current available financial information for the investment and the industry.

In addition to the financial instruments described above and the derivative instruments and CLO loans, bonds and debt, described below, other financial instruments that are carried at fair value or amounts that approximate fair value include Cash and cash equivalents and Short-term borrowings. The fair value of Long-term debt at March 31, 2011 and 2010 was \$1,322,960 and \$1,265,418, respectively. These fair values were estimated using current market prices.

### **Derivative Instruments**

The fair values of derivative instruments are recorded as assets or liabilities on the Consolidated Balance Sheets. Legg Mason has used foreign exchange forwards and interest rate swaps to hedge the risk of movement in exchange rates or interest rates on financial assets on a limited basis. Also, Legg Mason has used futures contracts on index funds to hedge the market risk of certain seed capital investments. In addition, certain CIVs use derivative instruments. However, 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.

Legg Mason applied hedge accounting as defined in the accounting literature to a debt interest rate risk hedge, which matured in fiscal 2009. Adjustment of this cash flow hedge was recorded in Other comprehensive income (loss) until it matured, at which time it was realized in Other non-operating income (expense). The gains or losses on other derivative instruments not designated for hedge accounting are included as Other

income (expense) or Other non-operating income (expense) in the Consolidated Statements of Income except as described below.

Gains and losses on derivative instruments of CIVs are recorded as Other non-operating income (expense) of consolidated investment vehicles, net, in the Consolidated Statements of Income.

In fiscal 2009, Legg Mason had various credit support arrangements for certain liquidity funds managed by a subsidiary. These arrangements included letters of credit (“LOCs”), capital support agreements (“CSAs”) and a total return swap (“TRS”) that qualified as derivative transactions. The fair values of these derivative instruments were based on expected outcomes derived from pricing data for the underlying securities and/or detailed collateral analyses based on the most recent available information. There were no related derivative assets or liabilities as of March 31, 2011 and 2010. None of these derivative transactions were designated for hedge accounting as defined in the accounting guidance and the related gains and losses are included in Fund support in the Consolidated Statement of Operations.

### **Fair Value Measurements**

Accounting guidance for fair value measurements defines fair value and establishes a framework for measuring fair value. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Under the accounting guidance, a fair value measurement should reflect all of the assumptions that market participants would use in pricing the asset or liability, including assumptions about the risk inherent in a particular valuation technique, the effect of a restriction on the sale or use of an asset, and the risk of non-performance.

The fair value accounting guidance reaffirms that the objective of fair value measurements is to reflect at the date of the financial statements how much an asset would be sold in an orderly transaction (as opposed to a distressed or forced transaction) under current market conditions. Specifically, it reaffirms the need to use judgment to ascertain if a formerly active market has become inactive and in determining fair values when markets have become inactive. This accounting guidance also relates to other-than temporary impairments

and is intended to bring greater consistency to the timing of impairment recognition. It is also intended to provide greater clarity to investors about the credit and noncredit components of impaired debt securities that are not expected to be sold. The guidance also requires increased and more timely disclosures regarding expected cash flows, credit losses, and an aging of securities with unrealized losses.

The fair value accounting guidance also establishes a hierarchy that prioritizes the inputs for valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

Legg Mason’s financial instruments measured and reported at fair value are classified and disclosed in one of the following categories:

Level 1—Financial instruments for which prices are quoted in active markets, which, for Legg Mason, include investments in publicly traded mutual funds with quoted market prices and equities listed in active markets.

Level 2—Financial instruments for which: prices are quoted for similar assets and liabilities in active markets; prices are quoted for identical or similar assets in inactive markets; or prices are based on observable inputs, other than quoted prices, such as models or other valuation methodologies. For Legg Mason, this category may include repurchase agreements, fixed income securities, and certain proprietary fund products. This category also includes CLO loans and liabilities of a CIV.

Level 3—Financial instruments for which values are based on unobservable inputs, including those for which there is little or no market activity. This category includes derivative liabilities related to fund support arrangements, investments in partnerships, limited liability companies, and private equity funds, and previously included derivative assets related to fund support arrangements and certain owned securities issued by structured investment vehicles (“SIVs”). This category may also include certain proprietary fund products with redemption restrictions and CLO debt of a CIV.

The valuation of an asset or liability may involve inputs from more than one level of the hierarchy. The level in the fair value hierarchy which a fair value

measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

Proprietary fund products and certain investments held by CIVs are valued at net asset value ("NAV") determined by the applicable fund administrator. These funds are typically invested in exchange traded investments with observable market prices. Their valuations may be classified as Level 1, Level 2 or Level 3 based on whether the fund is exchange traded, the frequency of the related NAV determinations and the impact of redemption restrictions. For investments in illiquid and privately-held securities (private equity and investment partnerships) for which market prices or quotations may not be readily available, including certain investments held by CIVs, management must estimate the value of the securities using a variety of methods and resources, including the most current available financial information for the investment and the industry to which it applies in order to determine fair value. These valuation processes for illiquid and privately-held securities inherently require management's judgment and are therefore classified in Level 3.

The fair values of CLO loans and bonds are determined based on prices from well-recognized third-party pricing services that utilize available market data and are therefore classified as Level 2. Legg Mason has established controls designed to assess the reasonableness of the prices provided. The fair value of CLO debt is valued using a discounted cash flow methodology. Inputs used to determine the expected cash flows include assumptions about forecasted default and recovery rates that a market participant would use in determining the fair value of the CLO's underlying collateral assets. Given the significance of the unobservable inputs to the fair value measurement, the CLO debt valuation is classified as Level 3.

Exchange traded options are valued using the last sale price or in the absence of a sale, the last offering price. Options traded over the counter are valued using dealer supplied valuations. Options are classified as Level 1. Futures contracts are valued at the last settlement price at the end of each day on the exchange upon which they are traded and are classified as Level 1. Index and single name credit default swaps and interest rate swaps are valued based on valuations furnished by pricing services and are classified as Level 2.

As a practical expedient, Legg Mason relies on the NAV of certain investments as their fair value. The NAVs that have been provided by investees are derived from the fair values of the underlying investments as of the reporting date.

Any transfers between categories are measured at the beginning of the period.

See Note 3 for additional information regarding fair value measurements.

### **Fair Value Option**

Legg Mason has elected the fair value option for certain eligible assets and liabilities, including corporate loans and debt, of a CLO it is consolidating (see Note 18). 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. Unrealized gains and losses on assets and liabilities for which the fair value option has been elected are reported in earnings. The decision to elect the fair value option is determined on an instrument by instrument basis, must be applied to an entire instrument and is irrevocable once elected. Assets and liabilities which are measured at fair value pursuant to the fair value option are included in the assets and liabilities of consolidated investment vehicles in the Consolidated Balance Sheets. At this time, the Company has not elected to apply the fair value option to any of its other financial instruments.

### **Appropriated Retained Earnings**

Upon the adoption of new consolidation guidance and the related election of the fair value option for eligible assets and liabilities of the CLO described above, Legg Mason recorded a cumulative effect adjustment to Appropriated retained earnings of consolidated investment vehicles on the Consolidated Balance Sheets equal to the difference between the fair values of the CLO's assets and liabilities. This difference is recorded as "Appropriated retained earnings" because the investors in the CLO, not Legg Mason shareholders, will ultimately realize any benefits or losses associated with the CLO. Beginning April 1, 2010, changes in the fair values of the CLO assets and liabilities are recorded as Net income (loss) attributable to noncontrolling interests in the Consolidated Statements of Income and Appropriated retained earnings of consolidated investment vehicles in the Consolidated Balance Sheets.



## Fixed Assets

Fixed assets consist of equipment, software and leasehold improvements and capital lease assets. Equipment consists primarily of communications and technology hardware and furniture and fixtures. Software includes both purchased software and internally developed software. Fixed assets are reported at cost, net of accumulated depreciation and amortization. Capital lease assets are initially reported at the lesser of the present value of the related future minimum lease payments or the asset's then current fair value, subsequently reduced by accumulated depreciation. Depreciation and amortization are determined by use of the straight-line method. Equipment is depreciated over the estimated useful lives of the assets, generally ranging from three to eight years. Software is amortized over the estimated useful lives of the assets, which are generally three years. Leasehold improvements and capital lease assets are amortized or depreciated over the initial term of the lease unless options to extend are likely to be exercised. Maintenance and repair costs are expensed as incurred. Internally developed software is reviewed periodically to determine if there is a change in the useful life, or if an impairment in value may exist. If impairment is deemed to exist, the asset is written down to its fair value or is written off if the asset is determined to no longer have any value.

## Intangible Assets and Goodwill

Intangible assets consist principally of asset management contracts, contracts to manage proprietary funds and trade names resulting from acquisitions. Intangible assets are amortized over their estimated useful lives, using the straight-line method, unless the asset is determined to have an indefinite useful life. Asset management contracts are amortizable intangible assets that are capitalized at acquisition and amortized over the expected life of the contract. The value of contracts to manage assets in proprietary funds and the value of trade names are classified as indefinite-life intangible assets. The assignment of indefinite lives to proprietary fund contracts is based upon the assumption that there is no foreseeable limit on the contract period to manage proprietary funds due to the likelihood of continued renewal at little or no cost. The assignment of indefinite lives to trade names is based on the assumption that they are expected to generate cash flows indefinitely.

Goodwill represents the excess cost of a business acquisition over the fair value of the net assets acquired. Indefinite-life intangible assets and goodwill are not

amortized for book purposes. Given the relative significance of intangible assets and goodwill to the Company's consolidated financial statements, on a quarterly basis Legg Mason considers if triggering events have occurred that may indicate that the fair values have declined below their respective carrying amounts. Triggering events may include significant adverse changes in the Company's business, legal or regulatory environment, loss of key personnel, significant business dispositions, or other events. If a triggering event has occurred, the Company will perform tests, which include critical reviews of all significant assumptions, to determine if any intangible assets or goodwill are impaired. At a minimum, the Company performs these tests annually at December 31, for indefinite-life intangible assets and goodwill, considering factors such as projected cash flows and revenue multiples, to determine whether the value of the assets is impaired and the indefinite-life assumptions are appropriate. If an asset is impaired, the difference between the value of the asset reflected on the financial statements and its current fair value is recognized as an expense in the period in which the impairment is determined. The fair values of intangible assets subject to amortization are reviewed at each reporting period using an undiscounted cash flow analysis. For intangible assets with indefinite lives, fair value is determined based on anticipated discounted cash flows. Goodwill is evaluated at the reporting unit level, and is deemed to be impaired if the carrying amount of the reporting unit exceeds its implied fair value. In estimating the fair value of the reporting unit, Legg Mason uses valuation techniques principally based on discounted cash flows similar to models employed in analyzing the purchase price of an acquisition target. Goodwill is deemed to be recoverable at the reporting unit level, which is also the operating segment level that Legg Mason defines as the Americas and International divisions. This results from the fact that operating segment management reports to the Chief Executive Officer, manages the business at the division level and does not regularly receive discrete financial information, such as operating results, at any lower level, such as the asset management affiliate level. Allocations of goodwill to Legg Mason's divisions for management restructures, acquisitions and dispositions are based on relative fair values of the respective businesses restructured, added to or sold from the divisions.

In December 2010, Legg Mason announced a realignment of its executive management team which, among other things, will eliminate the previous separation of the Americas and International divisions into one

Global Asset Management business during fiscal 2012. Although the Company announced the realignment of its executive management during the year, as of March 31, 2011, no changes had been made to the internal reporting practices and Legg Mason continued to operate in one reportable Asset Management segment, with two divisions, Americas and International.

See Note 5 for additional information regarding intangible assets and goodwill and Note 17 for additional business segment information.

### **Translation of Foreign Currencies**

Assets and liabilities of foreign subsidiaries that are denominated in non-U.S. dollar functional currencies are translated at exchange rates as of the Consolidated Balance Sheet dates. Revenues and expenses are translated at average exchange rates during the period. The gains or losses resulting from translating foreign currency financial statements into U.S. dollars are included in stockholders' equity and comprehensive income. Gains or losses resulting from foreign currency transactions are included in net income.

### **Investment Advisory Fees**

Legg Mason earns investment advisory fees on assets in separately managed accounts, investment funds, and other products managed for Legg Mason's clients. These fees are primarily based on predetermined percentages of the market value of the assets under management ("AUM"), are recognized over the period in which services are performed and may be billed in advance of the period earned based on AUM at the beginning of the billing period in accordance with the related advisory contracts. Revenue associated with advance billings is deferred and included in Other (current) liabilities in the Consolidated Balance Sheets and is recognized over the period earned. Performance fees may be earned on certain investment advisory contracts for exceeding performance benchmarks and are recognized at the end of the performance measurement period. Accordingly, neither advanced billings or performance fees are subject to reversal.

Legg Mason has responsibility for the valuation of AUM, substantially all of which is based on observable market data from independent pricing services, fund accounting agents, custodians or brokers.

### **Distribution and Service Fees Revenue and Expense**

Distribution and service fees represent fees earned from funds to reimburse the distributor for the costs

of marketing and selling fund shares and servicing proprietary funds and are generally determined as a percentage of client assets. Reported amounts also include fees earned from providing client or shareholder servicing, including record keeping or administrative services to proprietary funds. Distribution fees earned on company-sponsored investment funds are reported as revenue. When Legg Mason enters into arrangements with broker-dealers or other third parties to sell or market proprietary fund shares, distribution and service fee expense is accrued for the amounts owed to third parties, including finders' fees and referral fees paid to unaffiliated broker-dealers or introducing parties. Distribution and servicing expense also includes payments to third parties for certain shareholder administrative services and sub-advisory fees paid to unaffiliated asset managers.

### **Deferred Sales Commissions**

Commissions paid to financial intermediaries in connection with sales of certain classes of company-sponsored mutual funds are capitalized as deferred sales commissions. The asset is amortized over periods not exceeding six years, which represent the periods during which commissions are generally recovered from distribution and service fee revenues and from contingent deferred sales charges ("CDSC") received from shareholders of those funds upon redemption of their shares. CDSC receipts are recorded as distribution and servicing revenue when received and a reduction of the unamortized balance of deferred sales commissions, with a corresponding expense.

Management periodically tests the deferred sales commission asset for impairment by reviewing the changes in value of the related shares, the relevant market conditions and other events and circumstances that may indicate an impairment in value has occurred. If these factors indicate an impairment in value, management compares the carrying value to the estimated undiscounted cash flows expected to be generated by the asset over its remaining life. If management determines that the deferred sales commission asset is not fully recoverable, the asset will be deemed impaired and a loss will be recorded in the amount by which the recorded amount of the asset exceeds its estimated fair value. For the years ended March 31, 2011, 2010, and 2009, no impairment charges were recorded. Deferred sales commissions, included in Other non-current assets in the Consolidated Balance Sheets, were \$11,339 and \$15,271 at March 31, 2011 and 2010, respectively.

## **Income Taxes**

Deferred income taxes are provided for the effects of temporary differences between the tax basis of an asset or liability and its reported amount in the financial statements. Deferred income tax assets are subject to a valuation allowance if, in management's opinion, it is more likely than not that these benefits will not be realized. Legg Mason's deferred income taxes principally relate to net operating loss carryforwards, business combinations, amortization and accrued compensation.

Under applicable accounting guidance, a tax benefit should only be recognized if it is more likely than not that the position will be sustained based on its technical merits. A tax position that meets this threshold is measured as the largest amount of benefit that has a greater than 50% likelihood of being realized upon settlement by the appropriate taxing authority having full knowledge of all relevant information.

The Company's accounting policy is to classify interest related to tax matters as interest expense and related penalties, if any, as other operating expense.

See Note 8 for additional information regarding income taxes.

## **Loss Contingencies**

Legg Mason accrues estimates for loss contingencies related to legal actions, investigations, and proceedings, exclusive of legal fees, when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated.

## **Stock-based Compensation**

Legg Mason's stock-based compensation includes stock options, employee stock purchase plans, restricted stock awards, market-based performance shares payable in common stock and deferred compensation payable in stock. Under its stock compensation plans, Legg Mason issues equity awards to directors, officers, and other key employees.

In accordance with the applicable accounting guidance, compensation expense includes costs for all non-vested share-based awards at their grant date fair value amortized over the respective vesting periods on the straight-line method. Legg Mason determines the fair value of stock options using the Black-Scholes option-pricing model, with the exception of market-based performance grants, which are valued with a Monte Carlo option-pricing model. See Note 12 for additional information regarding stock-based compensation.

## **Earnings Per Share**

Basic earnings per share attributable to Legg Mason, Inc. common shareholders ("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, shares exchangeable into common stock and unvested share-based payment awards that are considered participating securities because they contain nonforfeitable rights to dividends. Diluted EPS is similar to basic EPS, but adjusts for the effect of potential common shares unless they are antidilutive. For periods with a net loss, potential common shares are considered antidilutive. See Note 13 for additional discussion of EPS.

## **Restructuring Costs**

In May 2010, Legg Mason's management committed to a plan to streamline its business model as further described in Note 16. The costs anticipated in connection with this plan primarily relate to employee termination benefits, incentives to retain employees during the transition period, and contract termination costs. Termination benefits, including severance, and retention incentives are recorded as Transition-related compensation in the Consolidated Statements of Income. These compensation items require employees to provide future service and are therefore expensed ratably over the required service period. Contract termination and other costs are expensed when incurred.

## Noncontrolling interests

Noncontrolling interests related to CIVs are classified as redeemable noncontrolling interests if investors in these funds may request withdrawals at any time. Redeemable noncontrolling interests as of and for the years ended March 31, 2011 and 2010, were as follows:

	2011	2010	2009
Balance, beginning of period	\$29,577	\$31,020	\$ 92
Net income attributable to redeemable noncontrolling interests	5,584	6,623	2,924
Net (redemptions/distributions)/subscriptions received from noncontrolling interest holders	1,551	(8,066)	28,004
Balance, end of period	\$36,712	\$29,577	\$31,020

## Other Recent Accounting Developments

The following relevant accounting pronouncements were recently issued.

On May 12, 2011, the FASB issued an update which clarifies and modifies existing fair value measurement and disclosure requirements. This update includes required qualitative disclosures for the sensitivity of fair value measurements to changes in unobservable inputs (Level 3) and the categorization by Level of the fair value hierarchy for items that are not measured at fair value in the balance sheet but for which the fair value is required to be disclosed (such as for debt). The update is effective for Legg Mason in fiscal 2013 and is not currently expected to have a material impact on Legg Mason's consolidated financial statements.

In December 2010, the FASB issued an update that clarifies goodwill impairment testing requirements. This update will be effective for Legg Mason's fiscal 2012. Legg Mason does not currently expect this guidance to have a material effect on its recorded goodwill.

In January 2010, the FASB issued an update that requires new disclosures about recurring and nonrecurring fair value measurements. The new disclosures include significant transfers into and out of Level 1 and 2 measurements and will change the current disclosure requirement of Level 3 measurement activity from a net basis to a gross basis. The amendment also clarifies existing disclosure guidance about the level of disaggregation, inputs and valuation techniques. The new and revised disclosures were effective for Legg Mason in fiscal 2011, except for the revised disclosures about Level 3 measurement activity, which are effective for Legg Mason in fiscal 2012. The disclosures are not expected to have a material impact on Legg Mason's consolidated financial statements.

## 2. ACQUISITIONS AND DISPOSITIONS

Effective November 1, 2005, Legg Mason acquired 80% of the outstanding equity of Permal, a leading global funds-of-hedge funds manager. Concurrent with the acquisition, Permal completed a reorganization in which the residual 20% of outstanding equity was converted to preference shares, with Legg Mason owning 100% of the outstanding voting common stock of Permal. During fiscal 2010, Legg Mason paid an aggregate of \$170,804 in cash to acquire the remaining 62.5% of the outstanding preference shares. The Company also elected to purchase, for \$9,000, the rights of the sellers of the preference shares to receive an earnout payment of up to \$149,200 in two years. As a result of this transaction, there will be no further payments for the Permal acquisition. In addition, during fiscal 2010 and 2009, Legg Mason paid an aggregate amount of \$15,048 in dividends on the preference shares. All payments for preference shares, including dividends, were recognized as additional goodwill.

In April 2008, Legg Mason completed a sale in which Citigroup Global Markets, Inc., an affiliate of Citigroup, acquired a majority of the overlay and implementation business of Legg Mason Private Portfolio Group, including its managed account trading and technology platform. The sale produced cash proceeds of approximately \$181,147. After transaction costs, the gain on the sale of this business was approximately \$5,540 (\$3,435 after tax), which was recognized in Other non-operating income (expense) in fiscal 2009.

In connection with the purchase of Private Capital Management, during fiscal 2007 Legg Mason paid from available cash the maximum fifth anniversary payment of \$300,000, of which \$150,000 remained in escrow subject to certain limited clawback provisions



through fiscal 2010. During fiscal 2009, the remaining contingency was settled by releasing approximately \$30,000 to the sellers and returning approximately \$120,000 to Legg Mason, which was recorded as a reduction of goodwill.

### 3. 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 18, Variable Interest Entities and Consolidation of Investment Vehicles, for information related to the assets and liabilities of CIVs that are measured at fair value.

Legg Mason has investments in debt and equity securities that are generally classified as available-for-sale and trading as described in Note 1. Investments as of March 31, 2011 and 2010, are as follows:

	2011	2010
Investment securities:		
Current investments <sup>(1)</sup>	<b>\$400,510</b>	\$334,873
Available-for-sale	<b>11,300</b>	6,957
Other <sup>(2)</sup>	<b>270</b>	1,452
<b>Total</b>	<b>\$412,080</b>	\$343,282

(1) Includes trading investments of deferred compensation plans of \$120,107 and \$118,096, respectively, and equity method investments of deferred compensation plans of \$48,528 and \$49,031, respectively. The remainder represents seed investments in proprietary fund products.

(2) Includes investments in private equity securities that do not have readily determinable fair values.

The net unrealized and realized gain (loss) for investment securities classified as trading was \$28,355, \$125,395, and (\$2,003,043) for fiscal 2011, 2010 and 2009, respectively. The realized and unrealized losses for fiscal 2009 primarily relate to losses on SIV-issued securities purchased from certain liquidity funds.

Legg Mason's available-for-sale investments consist of mortgage backed securities, U.S. government and agency securities and equity securities. Gross unrealized gains (losses) for investments classified as available-for-sale were \$157 and (\$186), respectively, as of March 31, 2011, and \$172 and (\$33), respectively, as of March 31, 2010.

Legg Mason uses the specific identification method to determine the cost of a security sold and the amount reclassified from accumulated other comprehensive income into earnings. The proceeds and gross realized gains and losses from sales and maturities of available-for-sale investments are as follows:

	Years Ended March 31,		
	2011	2010	2009
Available-for-sale:			
Proceeds	<b>\$4,012</b>	\$1,279	\$2,173
Gross realized gains	<b>7</b>	1	5
Gross realized losses	<b>(19)</b>	(4)	(84)

Legg Mason had no investments classified as held-to-maturity as of March 31, 2011 and 2010.

The fair values of financial assets and (liabilities) of the Company were determined using the following categories of inputs at March 31, 2011 and 2010:

	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Value as of March 31, 2011
<b>ASSETS:</b>				
Cash equivalents <sup>(1)</sup>				
Money market funds	\$ 912,951	\$ —	\$ —	\$ 912,951
Time deposits	—	92,877	—	92,877
Total cash equivalents	912,951	92,877	—	1,005,828
Investment securities:				
Trading investments relating to long-term incentive compensation plans <sup>(2)</sup>	120,107	—	—	120,107
Trading proprietary fund products and other investments <sup>(3)</sup>	90,123	102,562	11,378	204,063
Equity method investments relating to long-term incentive compensation plans, proprietary fund products and other investments <sup>(4)</sup>	15,645	48,528	12,167	76,340
Total current investments	225,875	151,090	23,545	400,510
Available-for-sale investment securities	2,666	8,622	12	11,300
Investments in partnerships, LLCs, and other	—	—	22,167	22,167
Equity method investments in partnerships and LLCs	1,420	—	153,931	155,351
Derivative assets:				
Currency and market hedge	1,169	—	—	1,169
Other investments	—	—	270	270
	<b>\$1,144,081</b>	<b>\$252,589</b>	<b>\$199,925</b>	<b>\$1,596,595</b>
<b>LIABILITIES:</b>				
Derivative liabilities:				
Currency and market hedge	\$ (3,120)	\$ —	\$ —	\$ (3,120)

	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Value as of March 31, 2010
<b>ASSETS:</b>				
Cash equivalents <sup>(1)</sup>				
Money market funds	\$ 930,015	\$ —	\$ —	\$ 930,015
Time deposits	—	249,352	—	249,352
Total cash equivalents	930,015	249,352	—	1,179,367
Investment securities:				
Trading investments relating to long-term incentive compensation plans <sup>(2)</sup>	118,096	—	—	118,096
Trading proprietary fund products and other investments <sup>(3)</sup>	52,375	67,663	22,459	142,497
Equity method investments relating to long-term incentive compensation plans, proprietary fund products and other investments <sup>(4)</sup>	13,159	49,031	12,090	74,280
Total current investments	183,630	116,694	34,549	334,873
Available-for-sale investment securities	2,533	4,412	12	6,957
Investments in partnerships, LLCs, and other	—	—	23,049	23,049
Equity method investments in partnerships and LLCs	1,192	—	98,968	100,160
Derivative assets:				
Currency and market hedge	697	—	—	697
Other investments	—	—	1,452	1,452
	\$1,118,067	\$370,458	\$158,030	\$1,646,555
<b>LIABILITIES:</b>				
Derivative liabilities:				
Currency and market hedge	\$ (485)	\$ —	\$ —	\$ (485)

(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 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 offset by an adjustment to compensation expense and related liability.

(3) Total proprietary fund products and other investments represent primarily mutual funds that are invested approximately 60% and 40% in equity and debt securities as of March 31, 2011, respectively, and were invested approximately 63% and 37% in equity and debt securities as of March 31, 2010, respectively.

(4) Includes investments under the equity method (which approximates fair value) relating to long-term incentive compensation plans of \$48,528 and \$49,031 as of March 31, 2011 and 2010, respectively, and proprietary fund products and other investments of \$27,812 and \$25,249 as of March 31, 2011 and 2010, respectively, which are classified as Investment securities on the Consolidated Balance Sheets.

The table below presents a summary of changes in financial assets and (liabilities) measured at fair value using significant unobservable inputs (Level 3) for the periods from March 31, 2010 to March 31, 2011 and March 31, 2009 to March 31, 2010:

	Value as of March 31, 2010	Purchases, sales, issuances and settlements, net	Net transfer in (out) of Level 3	Realized and unrealized gains/(losses), net	Value as of March 31, 2011
<b>ASSETS:</b>					
Proprietary fund products and other investments	\$ 22,459	\$(13,429)	\$350	\$ 1,998	<b>\$ 11,378</b>
Equity method investments in proprietary fund products	12,090	—	—	77	<b>12,167</b>
Investments in partnerships, LLCs, and other	23,049	831	—	(1,713)	<b>22,167</b>
Equity method investments in partnerships and LLCs	98,968	29,335	—	25,628	<b>153,931</b>
Other investments	1,464	(4,065)	—	2,883	<b>282</b>
	<b>\$158,030</b>	<b>\$ 12,672</b>	<b>\$350</b>	<b>\$28,873</b>	<b>\$199,925</b>
	Value as of March 31, 2009	Purchases, sales, issuances and settlements, net	Net transfer in (out) of Level 3	Realized and unrealized gains/(losses), net	Value as of March 31, 2010
<b>ASSETS:</b>					
Proprietary fund products and other investments	\$ 26,937	\$(11,013)	\$ —	\$ 6,535	\$ 22,459
Equity method investments in proprietary fund products	9,531	—	—	2,559	12,090
Investments in partnerships, LLCs, and other	20,630	2,745	—	(326)	23,049
Equity method investments in partnerships and LLCs	33,584	61,042	—	4,342	98,968
Other investments	1,881	(779)	—	362	1,464
	<b>\$ 92,563</b>	<b>\$ 51,995</b>	<b>\$ —</b>	<b>\$13,472</b>	<b>\$158,030</b>
<b>LIABILITIES:</b>					
Fund support	\$ (20,631)	\$ —	\$ —	\$20,631	\$ —
Total realized and unrealized gains, net				\$34,103	

Realized and unrealized gains and losses recorded for Level 3 investments are included in Fund support and Other income (expense) on the Consolidated Statements of Income. The change in unrealized gains (losses) relating to Level 3 assets and liabilities still held at the reporting date was \$11,472 and \$35,026 for the years ended March 31, 2011 and 2010, respectively.

There were no significant transfers between Levels 1 and 2 during the year ended March 31, 2011.



As a practical expedient, Legg Mason relies on the net asset value of certain investments as their fair value. The net asset values 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 March 31, 2011, the nature of these investments and any related liquidation restrictions or other factors which may impact the ultimate value realized.

Category of Investment	Investment Strategy	Fair Value Determined Using NAV	Unfunded Commitments	Remaining Term
Funds-of-hedge funds	Global, fixed income, macro, long/short equity, natural resources, systematic, emerging market, European hedge	\$ 69,997 <sup>(1)</sup>	n/a	n/a
Private funds	Long/short equity	22,372 <sup>(2)</sup>	7,882	6 to 9 years
Private fund	Fixed income, residential and commercial mortgage-backed securities	91,866 <sup>(2)</sup>	n/a	7 years, subject to two one-year extensions
Other	Various	13,652 <sup>(2)</sup>	n/a	Various <sup>(3)</sup>
<b>Total</b>		<b>\$197,887</b>	<b>\$7,882</b>	

n/a—not applicable

(1) 73% monthly redemption; 27% quarterly redemption, 34% of which is subject to two-year lock-up.

(2) Liquidations are expected during the remaining term.

(3) 82% two-year remaining term; 18% 20-year remaining term.

There are no current plans to sell any of these investments.

#### 4. FIXED ASSETS

The following table reflects the components of fixed assets as of March 31:

	2011	2010
Equipment	\$ 200,696	\$ 196,624
Software	224,026	212,835
Leasehold improvements	280,277	306,435
Total cost	704,999	715,894
Less: accumulated depreciation and amortization	(418,294)	(354,075)
<b>Fixed assets, net</b>	<b>\$ 286,705</b>	<b>\$ 361,819</b>

In connection with its restructuring plans discussed in Note 16, Legg Mason concluded during the year ended March 31, 2011 that it no longer intends to exercise a put/purchase option on land and a building that serves as its operations and technology facility that was accounted for as a capital lease in fiscal 2010. As a result of the decision, a \$4,134 escrow deposit was charged to occupancy expense as a transition-related cost and, effective December 31, 2010, the lease is being accounted for as an operating lease.

Depreciation and amortization expense related to fixed assets was \$79,835, \$91,309, and \$101,957 for fiscal 2011, 2010, and 2009, respectively.

#### 5. INTANGIBLE ASSETS AND GOODWILL

Goodwill and indefinite-life intangible assets are not amortized and the values of identifiable intangible assets are amortized over their useful lives, unless the assets are determined to have indefinite useful lives. Goodwill and indefinite-life intangible assets are analyzed to determine if the fair value of the assets exceeds the book value. Intangible assets subject to amortization are considered for impairment at each reporting period. If the fair value is less than the book value, Legg Mason will record an impairment charge.

The following tables reflect the components of intangible assets as of March 31:

	2011	2010
<b>Amortizable asset</b>		
<b>management contracts</b>		
Cost	\$ 207,113	\$ 212,333
Accumulated amortization	(153,795)	(133,210)
Net	53,318	79,123
<b>Indefinite-life intangible assets</b>		
Fund management contracts	3,753,657	3,753,299
Trade names	69,800	69,800
	3,823,457	3,823,099
<b>Intangible assets, net</b>	<b>\$3,876,775</b>	<b>\$3,902,222</b>

As of March 31, 2011, management contracts are being amortized over a weighted-average life of 3.6 years.

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

2012	\$19,584
2013	14,085
2014	11,902
2015	2,987
2016	2,731
Thereafter	2,029
<b>Total</b>	<b>\$53,318</b>

The change in indefinite-life intangible assets is attributable to the impact of foreign currency translation. Legg Mason completed its most recent annual impairment tests of indefinite-life intangible assets as of December 31, 2010, and determined that there was no impairment in the value of these assets during fiscal 2011 and also determined that no triggering events occurred as of March 31, 2011 that would require further impairment testing.

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

	Gross Book Value	Accumulated Impairment	Net Book Value
Balance as of March 31, 2009	\$2,348,647	\$(1,161,900)	\$1,186,747
Business acquisitions and related costs (see Note 2)	11,968	—	11,968
Contractual acquisition earnout payments (see Note 2)	98,804	—	98,804
Impact of excess tax basis amortization	(18,920)	—	(18,920)
Other, including changes in foreign exchange rates	36,697	—	36,697
Balance as of March 31, 2010	2,477,196	(1,161,900)	1,315,296
Impact of excess tax basis amortization	(22,735)	—	(22,735)
Other, including changes in foreign exchange rates	19,091	—	19,091
<b>Balance as of March 31, 2011</b>	<b>\$2,473,552</b>	<b>\$(1,161,900)</b>	<b>\$1,311,652</b>

Legg Mason completed its most recent annual impairment test of goodwill as of December 31, 2010, and determined that there was no impairment in the value of these assets during fiscal 2011. Legg Mason also determined that no triggering events occurred as of March 31, 2011 that would require further impairment testing.

Based on the earnings of Permal, in November 2009, Legg Mason paid \$170,804, of which \$81,000 was accrued in fiscal 2008, in a fourth anniversary payment under the purchase contract for the acquisition of the remaining preference shares issued by Permal, which was recognized with a corresponding increase in goodwill. In addition, in December 2009, Legg Mason elected to purchase, for \$9,000, the rights of the sellers of the preference shares to receive an earnout payment on the sixth anniversary in November 2011 of up to \$149,200. The \$9,000 purchase amount represents the fair value of the obligation and also resulted in an increase in goodwill.

Legg Mason also recognizes the tax benefit of the amortization of excess tax basis related to the CAM acquisition. In accordance with accounting guidance for income taxes, the tax benefit is recorded as a reduction of goodwill and deferred tax liabilities as the benefit is realized.

## 6. SHORT-TERM BORROWINGS

In March 2009, Legg Mason repaid \$250,000 of the \$500,000 outstanding borrowings under a \$1,000,000 revolving credit facility which was also amended to decrease the maximum amount of the facility to \$500,000. On February 11, 2010, the revolving credit agreement was amended to extend the expiration of the commitments and the maturity date of the loans outstanding to February 2013. As of March 31, 2011 and 2010, the revolving credit facility rate was LIBOR plus 262.5 basis points and the effective interest rate was 2.9%. The facility rate may change in the future based on changes in Legg Mason's credit ratings or LIBOR rates. As of March 31, 2011 and 2010, there was \$250,000 outstanding under this facility.

The Company's revolving credit facility is substantially with the same lenders as the \$550,000 five-year term loan, which was repaid in full during fiscal 2010, described in Note 7 below. This facility has standard financial covenants that were revised during fiscal 2010, including a maximum net debt to EBITDA ratio of 2.5 (previously 3.0 on gross debt) and minimum EBITDA to interest ratio of 4.0. As of March 31, 2011, Legg Mason's net debt to EBITDA ratio was 1.1 and EBITDA to interest expense ratio was 12.9. Legg Mason has maintained compliance with the applicable

covenants but if it is determined that compliance with these covenants may be under pressure, a number of actions may be taken, including reducing expenses to increase EBITDA, using available cash to repay all or a portion of the \$250,000 outstanding debt subject to these covenants or seeking to negotiate with lenders to modify the terms or to restructure the debt.

A subsidiary of Legg Mason maintains a credit line for general operating purposes. In May 2010, the maximum amount that may be borrowed on this credit line was increased from \$12,000 to \$15,000. There were

no borrowings outstanding under this facility as of March 31, 2011 and 2010.

Another subsidiary of Legg Mason had a \$100,000, one-year revolving credit agreement for general operating purposes that expired in September 2009 with no borrowings outstanding.

## 7. LONG-TERM DEBT

The disclosures below include details of Legg Mason's debt, excluding the debt of CIVs. See Note 18, 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:

	2011			2010
	Current Accreted Value	Unamortized Discount	Maturity Amount	Current Accreted Value
2.5% convertible senior notes	\$1,087,932	\$162,068	\$1,250,000	\$1,051,243
5.6% senior notes from Equity Units	103,039	—	103,039	103,039
Third-party distribution financing	—	—	—	1,639
Other term loans	10,897	—	10,897	14,413
Subtotal	1,201,868	162,068	1,363,936	1,170,334
Less: current portion	792	—	792	5,154
Total	\$1,201,076	\$162,068	\$1,363,144	\$1,165,180

### 2.5% Convertible Senior Notes and Related Hedge Transactions

On January 14, 2008, Legg Mason sold \$1,250,000 of 2.5% convertible senior notes (the "Notes"). The Notes bear interest at 2.5%, payable semi-annually in cash. Legg Mason is accreting the carrying value to the principal amount at maturity using an imputed interest rate of 6.5% (the effective borrowing rate for nonconvertible debt at the time of issuance) over its expected life of seven years, resulting in additional interest expense for fiscal 2011, 2010, and 2009 of \$36,688, \$34,445, and \$32,340 respectively. The Notes are convertible, if certain conditions are met, at an initial conversion rate of 11.3636 shares of Legg Mason common stock per one thousand dollar principal amount of Notes (equivalent to a conversion price of approximately \$88.00 per share), or a maximum of 14,205 shares, subject to adjustment. Unconverted notes mature at par in January 2015. Upon conversion of a one thousand dollar principal amount note, the holder will receive cash in an amount equal to one thousand dollars or, if less, the conversion value of the note. If the conversion value exceeds the principal amount of the Note at conversion, Legg Mason will also deliver, at its election, cash or common stock

or a combination of cash and common stock for the conversion value in excess of one thousand dollars. The amount by which the accreted value of the Notes exceeds their if-converted value as of March 31, 2011 (representing a potential loss) is approximately \$121,690 using a current interest rate of 3.50%. The agreement governing the issuance of the notes contains certain covenants for the benefit of the initial purchaser of the notes, including leverage and interest coverage ratio requirements, that may result in the notes becoming immediately due and payable if the covenants are not met. The leverage covenant was waived to accommodate the Equity Units issuance in May 2008. This waiver will expire in June 2011. Otherwise, Legg Mason has maintained compliance with the applicable covenants.

In connection with the sale of the Notes, on January 14, 2008, Legg Mason entered into convertible note hedge transactions with respect to its common stock (the "Purchased Call Options") with financial institution counterparties ("Hedge Providers"). The Purchased Call Options are exercisable solely in connection with any conversions of the Notes in the event that the market value per share of Legg Mason common stock at the time of exercise is greater than the exercise price of

the Purchased Call Options, which is equal to the \$88 conversion price of the Notes, subject to adjustment. Simultaneously, in separate transactions Legg Mason also sold to the Hedge Providers warrants to purchase, in the aggregate and subject to adjustment, 14,205 shares of common stock on a net share settled basis at an exercise price of \$107.46 per share of common stock. The Purchased Call Options and warrants are not part of the terms of the Notes and will not affect the holders' rights under the Notes. These hedging transactions had a net cost of approximately \$83,000, which was paid from the proceeds of the Notes and recorded as a reduction of additional paid-in capital.

If, when the Notes are converted, the market price per share of Legg Mason common stock exceeds the \$88 exercise price of the Purchased Call Options, the Purchased Call Options entitle Legg Mason to receive from the Hedge Providers shares of Legg Mason common stock, cash, or a combination of shares of common stock and cash, that will match the shares or cash Legg Mason must deliver under terms of the Notes. Additionally, if at the same time the market price per share of Legg Mason common stock exceeds the \$107.46 exercise price of the warrants, Legg Mason will be required to deliver to the Hedge Providers net shares of common stock, in an amount based on the excess of such market price per share of common stock over the exercise price of the warrants. These transactions effectively increase the conversion price of the Notes to \$107.46 per share of common stock. Legg Mason has contractual rights, and, at execution of the related agreements, had the ability to settle its obligations under the conversion feature of the Notes, the Purchased Call Options and warrants, with Legg Mason common stock. Accordingly, these transactions are accounted for as equity, with no subsequent adjustment for changes in the value of these obligations.

### **5.6% Senior Notes from Equity Units**

In May 2008, Legg Mason issued 23,000 Equity Units for \$1,150,000, of which approximately \$50,000 was used to pay issuance costs. Each unit consists of a 5% interest in one thousand dollar principal amount of 5.6% senior notes due June 30, 2021 and a detachable contract to purchase a varying number of shares of Legg Mason's common stock for \$50 by June 30, 2011. The notes and purchase contracts are separate and distinct instruments, but their terms are structured to simulate a conversion of debt to equity and potentially remarketed debt approximately three years

after issuance. The holders' obligations to purchase shares of Legg Mason's common stock are collateralized by their pledge of the notes or other prescribed collateral. In connection with the issuance of the Equity Units, Legg Mason incurred issuance costs of \$36,200, of which \$27,600 was allocated to the equity component of the Equity Units and recorded as a reduction of Additional paid-in capital. The notes are considered to be mandatorily convertible. For their commitment to purchase shares of Legg Mason's common stock, holders also receive quarterly payments, referred to as Contract Adjustment Payments ("CAP"), at a fixed annual rate of 1.4% of the commitment amount over the three-year contract term. Upon issuance of the Equity Units, Legg Mason recognized an approximately \$45,800 liability for the fair value of its obligation (based upon discounted cash flows) to pay unitholders a quarterly contract adjustment payment. This amount also represented the fair value of Legg Mason's commitment under the contract to issue shares of common stock in the future at designated prices, and was recorded as a reduction to Additional paid-in capital. The CAP obligation liability is being accreted over the approximate three-year contract term by charges to Interest expense based on a constant rate calculation. Subsequent contract adjustment payments reduce the CAP obligation liability, which as of March 31, 2011 and 2010, was \$168 and \$1,610, respectively, and is included in Other liabilities on the Consolidated Balance Sheets. The decrease in the CAP obligation liability was primarily due to the Equity Unit extinguishment discussed below.

Each purchase contract obligates Legg Mason to sell a number of newly issued shares of common stock that are based on a settlement rate determined by Legg Mason's stock price at the purchase date. The settlement rate adjusts with the price of Legg Mason stock in a way intended to maintain the original investment value when Legg Mason's common stock is priced between \$56.30 and \$67.56 per share. The settlement rate is 0.7401 shares of Legg Mason common stock, subject to adjustment, for each Equity Unit if the market value of Legg Mason common stock is at or above \$67.56. The settlement rate is 0.8881 shares of Legg Mason common stock, subject to adjustment, for each Equity Unit if the market value of Legg Mason common stock is at or below \$56.30. If the market value of Legg Mason common stock is between \$56.30 and \$67.56, the settlement rate will be a number of shares of Legg Mason common stock equal to \$50 divided by the market value.

During the September 2009 quarter, Legg Mason completed a tender offer and retired 91% of its outstanding Equity Units (20,939 units) including the extinguishment of \$1,050,000 of its outstanding 5.6% Senior notes and termination of the related purchase contracts in exchange for the issuance of approximately 18,596 shares of Legg Mason common stock and a payment of approximately \$130,870 in cash. The cash payment was allocated between the liability and equity components of the Equity Units based on relative fair values, resulting in a loss on debt extinguishment of approximately \$22,040 (including a non-cash charge of approximately \$6,355 of accelerated expense of deferred issue costs) and a decrease in additional paid-in capital of approximately \$115,186. The maximum number of shares that may be issued for the remaining Equity Units, subject to adjustment, is approximately 1,830. As the purchase contracts were deemed to be equity upon issuance, Legg Mason will not incur a gain or loss on the outstanding Equity Units, if settled in accordance with their original terms.

Shares of Legg Mason's common stock issuable under the Equity Unit purchase contracts are currently antidilutive under the treasury stock method because the market price of Legg Mason common stock is less than \$67.56 per share. In the event the probability of a successful remarketing of the Equity Unit notes becomes remote, the amount of shares issuable under the purchase contracts that must be included in diluted earnings per share would be determined under the if-converted method.

Legg Mason is required to attempt to remarket the notes by June 30, 2011. Upon a successful remarketing, the interest rate and maturity date of the senior notes will be reset such that the notes may remain outstanding for some time after the exercise of the purchase contracts and the related issuance of Legg Mason common shares. If such remarketing is not successful during this period, the note holders can put their notes at par to Legg Mason upon the settlement of the purchase contracts. Further, notes not redeemed or remarketed by June 30, 2013, can be called at par by Legg Mason. Legg Mason is in the process of evaluating its options for remarketing the Senior Notes by June 30, 2011.

### Third-party Distribution Financing

On July 31, 2006, a subsidiary of Legg Mason entered into a four-year agreement with a financial institution to finance, on a non-recourse basis, up to \$90,700 for commissions paid to financial intermediaries in connection with sales of certain share classes of proprietary funds. In April 2009, Legg Mason terminated the agreement and there was no balance outstanding as of March 31, 2011.

### Five-Year Term Loan

On October 14, 2005, Legg Mason entered into an unsecured term loan agreement for an amount not to exceed \$700,000. Legg Mason used this term loan to pay a portion of the purchase price, including acquisition related costs, in the acquisition of CAM. During fiscal 2008 and 2007, Legg Mason repaid an aggregate of \$150,000 of the outstanding borrowings on this term loan, and did not make any payments during fiscal 2009. In January 2010, Legg Mason repaid in full the \$550,000 of remaining outstanding borrowings under this term loan.

### Other Term Loans

A subsidiary of Legg Mason entered into a loan in fiscal 2005 to finance leasehold improvements. The outstanding balance at March 31, 2010 was \$2,349, and was paid in full on October 31, 2010. In fiscal 2006, a subsidiary of Legg Mason entered into a \$12,803 term loan agreement to finance an aircraft. The loan bears interest at 5.9%, is secured by the aircraft, and has a maturity date of January 1, 2016. The outstanding balance at March 31, 2011 was \$9,363.

As of March 31, 2011, the aggregate maturities of long-term debt, based on their contractual terms, are as follows:

2012	\$ 987
2013	1,226
2014	1,277
2015	1,251,332
2016	6,075
Thereafter	103,039
<b>Total</b>	<b>\$1,363,936</b>



## 8. INCOME TAXES

The components of income (loss) before income tax provision (benefit) are as follows:

	2011	2010	2009
Domestic	\$244,079	\$207,210	\$(3,053,327)
Foreign	121,118	122,446	(134,870)
Total	\$365,197	\$329,656	\$(3,188,197)

The components of income tax expense (benefit) are as follows:

	2011	2010	2009
Federal	\$ 75,290	\$ 78,224	\$(1,075,462)
Foreign	18,788	14,066	32,845
State and local	25,356	26,386	(180,586)
Total income tax provision (benefit)	\$119,434	\$118,676	\$(1,223,203)
Current	\$39,162	\$4,729	\$(405,726)
Deferred	80,272	113,947	(817,477)
Total income tax provision (benefit)	\$119,434	\$118,676	\$(1,223,203)

Legg Mason received approximately \$580,000 in tax refunds during the June 2009 quarter, primarily attributable to the utilization of \$1,600,000 of realized losses incurred in fiscal 2009 on the sale of securities issued by SIVs. Federal legislation, enacted in November 2009

to temporarily extend the net operating loss carryback period from two to five years enabled Legg Mason to utilize an additional \$1,300,000 of net operating loss deductions and, as a result, an additional \$459,000 in tax refunds was received in January 2010.

A reconciliation of the difference between the effective income tax rate and the statutory federal income tax rate is as follows:

	2011	2010 <sup>(1)</sup>	2009 <sup>(1)</sup>
Tax provision (benefit) at statutory U.S. federal income tax rate	35.0%	35.0%	(35.0)%
State income taxes, net of federal income tax benefit <sup>(2)</sup>	4.9	2.5	(3.3)
Effect of foreign tax rates <sup>(2)</sup>	(4.6)	(3.5)	0.1
Loss on Canadian restructuring	—	—	(2.9)
Changes in U.K. tax rates on deferred tax assets and liabilities	(2.5)	—	—
Non-deductible goodwill impairment	—	—	2.5
Other, net	(0.1)	2.0	0.2
Effective income tax (benefit) rate	32.7%	36.0%	(38.4)%

(1) Certain prior year amounts have been reclassified to conform with the current year presentation.

(2) State income taxes include changes in valuation allowances, net of the impact on deferred tax assets of changes in state apportionment factors and planning strategies. The effect of foreign tax rates also includes changes in valuation allowances.

During the quarter ended September 30, 2010, the United Kingdom ("U.K.") enacted the Finance Act of 2010, which reduced the corporate tax rate from 28% to 27% for tax periods commencing April 1, 2011 and after. The impact on prior deferred tax assets and liabilities at the time of the change in fiscal 2011 was a one-time tax benefit approximating \$8,900. Although not yet enacted, additional proposed reductions in the

U.K. corporate tax rate to 26% in fiscal 2012 and 25% in fiscal 2013 are expected. Each one percentage point reduction in the U.K. corporate tax rate will result in a tax benefit of approximately \$8,900 at the time of enactment, based on the amount of deferred tax assets and liabilities as of March 31, 2011, that have to be revalued at the new rate.

Deferred income taxes are provided for the effects of temporary differences between the tax basis of an asset or liability and its reported amount in the Consolidated Balance Sheets. These temporary differences result in taxable or deductible amounts in future years. A summary of Legg Mason's deferred tax assets and liabilities are as follows:

	2011	2010
<b>DEFERRED TAX ASSETS</b>		
Accrued compensation and benefits	<b>\$129,320</b>	\$129,389
Accrued expenses	<b>46,650</b>	55,252
Operating loss carryforwards	<b>375,703</b>	270,672
Capital loss carryforwards	<b>44,475</b>	42,404
Convertible debt obligations	<b>4,609</b>	6,579
Foreign tax credit carryforward	<b>45,119</b>	40,617
Federal benefit of uncertain tax positions	<b>17,451</b>	8,921
Other	<b>6,947</b>	17,691
Deferred tax assets	<b>670,274</b>	571,525
Valuation allowance	<b>(94,541)</b>	(87,605)
Deferred tax assets after valuation allowance	<b>\$575,733</b>	\$483,920
<b>DEFERRED TAX LIABILITIES</b>		
Basis differences, principally for intangible assets and goodwill	<b>\$229,879</b>	\$246,288
Depreciation and amortization	<b>295,699</b>	169,069
Other	<b>1,780</b>	630
Deferred tax liabilities	<b>527,358</b>	415,987
Net deferred tax asset	<b>\$ 48,375</b>	\$ 67,933

Certain tax benefits associated with Legg Mason's employee stock plans are recorded directly in Stockholders' Equity. No tax benefit was recorded to equity in 2009, 2010 or 2011 due to the net operating loss position of the Company. As of March 31, 2011, an additional \$4,700 of net operating loss will be recognized as an increase in Stockholders' Equity when ultimately realized.

In connection with the completion and filing of its fiscal 2010 federal tax return in December 2010, Legg Mason recorded a net additional tax benefit of approximately \$36,000 with respect to the Equity Unit extinguishment that occurred in fiscal 2010. The tax benefit increases Additional paid-in capital in a manner consistent with the fiscal 2010 allocation of the extinguishment payment.

Legg Mason has various loss carryforwards that may provide future tax benefits. Related valuation allowances are established in accordance with accounting guidance for income taxes, if it is management's opinion that it is more likely than not that these benefits will not be realized. Substantially all of Legg Mason's deferred tax assets relate to U.S. and United Kingdom

("U.K.") taxing jurisdictions. As of March 31, 2011, U.S. federal deferred tax assets aggregated \$683,200, realization of which is expected to require approximately \$4,600,000 of future U.S. earnings, approximately \$129,000 of which must be in the form of foreign source income. Based on estimates of future taxable income, using assumptions consistent with those used in Legg Mason's goodwill impairment testing, it is more likely than not that current federal tax benefits relating to net operating losses are realizable and no valuation allowance is necessary at this time. With respect to those resulting from foreign tax credits, it is more likely than not that tax benefits relating to \$4,800 foreign tax credits will not be realized and a valuation allowance of \$3,131 was established in fiscal 2011. As of March 31, 2011, U.S. state deferred tax assets aggregated \$221,700. Due to limitations on net operating loss and capital loss carryforwards and, taking into consideration certain state tax planning strategies, a valuation allowance was established for the state capital loss and net operating loss benefits in certain jurisdictions. An additional valuation allowance of \$700 was recorded for fiscal 2011. Due to the uncertainty of future state apportionment factors and future

effective state tax rates, the value of state net operating loss benefits ultimately realized may vary. As of March 31, 2011, U.K. deferred tax assets, net of valuation allowances, are not material. An additional valuation allowance of \$3,024 was recorded on foreign deferred tax assets relating to various jurisdictions, principally relating to foreign currency translation adjustments recognized in equity. To the extent the

analysis of the realization of deferred tax assets relies on deferred tax liabilities, Legg Mason has considered the timing, nature and jurisdiction of reversals, as well as, future increases relating to the tax amortization of goodwill and indefinite-life intangible assets. While tax planning may enhance Legg Mason's tax positions, the realization of these current tax benefits is not dependent on any significant tax strategies.

The following deferred tax assets and valuation allowances relating to carryforwards have been recorded at March 31, 2011 and 2010, respectively.

	2011	2010	Expires Beginning after Fiscal Year
Deferred tax assets			
U.S. federal net operating losses	<b>\$203,971</b>	\$119,328	2029
U.S. federal foreign tax credits	<b>45,119</b>	40,617	2015
U.S. state net operating losses <sup>(1,2,3)</sup>	<b>143,542</b>	121,475	2015
U.S. state capital losses	<b>36,749</b>	34,833	2015
Non-U.S. net operating losses	<b>28,190</b>	29,869	2011
Non-U.S. capital losses <sup>(1)</sup>	<b>7,726</b>	7,571	n/a
<b>Total deferred tax assets for carryforwards</b>	<b>\$465,297</b>	<b>\$353,693</b>	
Valuation allowances			
U.S. federal foreign tax credits	<b>\$ 3,131</b>	\$ —	
U.S. state net operating losses	<b>14,206</b>	15,341	
U.S. state capital losses	<b>36,749</b>	34,833	
Non-U.S. net operating losses	<b>28,190</b>	29,860	
Non-U.S. capital losses	<b>7,726</b>	7,571	
<b>Valuation allowances for carryforwards</b>	<b>90,002</b>	<b>87,605</b>	
Non-U.S. other deferred assets	<b>4,539</b>	—	
<b>Total valuation allowances</b>	<b>\$ 94,541</b>	<b>\$ 87,605</b>	

(1) Due to the Permal acquisition structure, for periods prior to December 1, 2009, U.S. subsidiaries of Permal filed separate federal income tax returns, apart from Legg Mason Inc.'s consolidated federal income tax return, and separate state income tax returns.

(2) Substantially all of the U.S. state net operating losses carryforward through fiscal 2029.

(3) Due to potential for change in the factors relating to apportionment of income to various states, the Company's effective state tax rates are subject to fluctuation which will impact the value of the Company's deferred tax assets, including net operating losses, and could have a material impact on the future effective tax rate of the Company.

Legg Mason had total gross unrecognized tax benefits of approximately \$77,653, \$51,027 and \$43,662 as of March 31, 2011, 2010, and 2009, respectively. Of these totals, approximately \$53,500, \$40,600 and \$33,900,

respectively, (net of the federal benefit for state tax liabilities) are the amounts of unrecognized benefits which, if recognized, would favorably impact future income tax provisions and effective tax rates.

A reconciliation of the beginning and ending amount of unrecognized gross tax benefits for the years ended March 31, 2011, 2010 and 2009 is as follows:

	2011	2010	2009
Balance, beginning of year	<b>\$51,027</b>	\$43,662	\$ 29,287
Additions based on tax positions related to the current year	<b>1,361</b>	2,830	15,756
Additions for tax positions of prior years	<b>34,959</b>	12,664	14,366
Reductions for tax positions of prior years	<b>(6,107)</b>	(5,846)	(4,082)
Decreases related to settlements with taxing authorities	<b>(2,667)</b>	(515)	(11,665)
Expiration of statute of limitations	<b>(920)</b>	(1,768)	—
Balance, end of year	<b>\$77,653</b>	\$51,027	\$ 43,662

Although management cannot predict with any degree of certainty the timing of ultimate resolution of matters under review by various taxing jurisdictions, it is reasonably possible that the Company's gross unrecognized tax benefits balance may change within the next twelve months by up to \$33,500 as a result of the expiration of statutes of limitation and the completion of tax authorities' exams.

The Company accrues interest related to unrecognized tax benefits in interest expense and recognizes penalties in other operating expense. During the years ended March 31, 2011, 2010, and 2009, the Company recognized approximately \$3,000, \$2,200, and \$5,400, respectively, which was substantially all interest. At March 31, 2011, 2010, and 2009, Legg Mason had approximately \$9,000, \$6,000, and \$5,000, respectively, accrued for interest and penalties on tax contingencies in the Consolidated Balance Sheets.

Legg Mason is under examination by the Internal Revenue Service and other tax authorities in various states. The following tax years remain open to income tax examination for each of the more significant jurisdictions where Legg Mason is subject to income taxes: after fiscal 2005 for U.S. federal; after fiscal 2005 for the United Kingdom; after fiscal 2003 for the state of California; after fiscal 2005 for the state of New York; and after fiscal 2007 for the states of Connecticut, Maryland and Massachusetts. The Company does not anticipate making any significant cash payments with the settlement of these audits.

In a prior year, Legg Mason initiated plans to repatriate earnings from certain foreign subsidiaries for up to \$225,000, of which \$189,000 has yet to be repatriated. Legg Mason still intends to repatriate these earnings to create foreign source income in order to utilize foreign tax credits that may otherwise expire unutilized.

No further repatriation beyond the original \$225,000 of foreign earnings is contemplated.

Except as noted above, Legg Mason intends to permanently reinvest cumulative undistributed earnings of its non-U.S. subsidiaries in non-U.S. operations. Accordingly, no U.S. federal income taxes have been provided for the undistributed earnings to the extent that they are permanently reinvested in Legg Mason's non-U.S. operations. It is not practical at this time to determine the income tax liability that would result upon repatriation of the earnings.

## 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 2025. Certain leases provide for renewal options and contain escalation clauses providing for increased rentals based upon maintenance, utility and tax increases.

As of March 31, 2011, the minimum annual aggregate rentals under operating leases and servicing agreements are as follows:

2012	\$ 142,259
2013	123,992
2014	100,072
2015	89,963
2016	83,135
Thereafter	522,145
<b>Total</b>	<b>\$1,061,566</b>

The minimum rental commitments in the table above have not been reduced by \$148,556 for minimum sublease rentals to be received in the future under non-cancelable subleases, of which approximately 55% is due from one counterparty. If a sub-tenant defaults on

a sublease, Legg Mason may have to 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 includes \$967,688 in real estate leases and equipment leases and \$93,878 in service and maintenance agreements.

As discussed in Note 4, in connection with its restructuring plans, Legg Mason no longer intends to exercise a put/purchase option on land and a building that was treated as a capital lease. As of March 31, 2011, the remaining rental commitment for this facility is included in the table above.

Included in the table above is \$13,337 in commitments related to office space that has been vacated, but for which subleases are being pursued. A lease liability was adjusted in fiscal 2011 and 2010 to reflect the present value of the excess existing lease obligations over the estimated sublease income and related costs. The lease liability takes into consideration various assumptions, including the amount of time it will take to secure a sublease agreement and prevailing rental rates in the applicable real estate markets. These, and other related costs incurred during fiscal 2011 and 2010, aggregated \$2,587 and \$19,331, respectively.

The following table reflects rental expense under all operating leases and servicing agreements.

	2011	2010	2009
Rental expense	<b>\$137,072</b>	\$137,771	\$127,949
Less: sublease income	<b>10,848</b>	8,573	15,488
Net rent expense	<b>\$126,224</b>	\$129,198	\$112,461

Legg Mason recognizes rent expense ratably over the lease period based upon the aggregate lease payments. The lease period is determined as the original lease term without renewals, unless and until the exercise of lease renewal options is reasonably assured, and also includes any period provided by the landlord as a "free rent" period. Aggregate lease payments include all rental payments specified in the contract, including contractual rent increases, and are reduced by any lease incentives received from the landlord, including those used for tenant improvements.

As of March 31, 2011 and 2010, Legg Mason had commitments to invest approximately \$23,381 and \$45,697, respectively, in limited partnerships that make private investments. These commitments will 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 which provide general indemnifications. 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. Legg Mason has also received subpoenas and is currently involved in governmental and self-regulatory agency inquiries, investigations and 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 the Citigroup transaction, 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 currently determined based on current information, after consultation with legal counsel, management believes that any accrual or range of reasonably possible losses as of March 31, 2011 or 2010, 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.



The ultimate resolution of other matters cannot be currently determined, and in the opinion of management, after consultation with legal counsel, Legg Mason believes that the resolution of these actions will not have a material adverse effect on Legg Mason's financial condition. Due in part to the preliminary nature of certain of these matters, Legg Mason is currently unable to estimate the amount or range of potential losses from these matters and the 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.

As of March 31, 2011 and 2010, Legg Mason's liability for losses and contingencies was \$500 and \$21,500, respectively. During fiscal 2011, 2010 and 2009, Legg Mason recorded litigation related charges of approximately \$2,500, \$21,200, and \$600, respectively. The charge in fiscal 2010 primarily represents a \$19,000 accrual for an affiliate investor settlement, which was settled during fiscal 2011. During fiscal 2011, 2010, and 2009, the liability was reduced for settlement payments of approximately \$23,500, \$1,500, and \$500, respectively.

## **10. EMPLOYEE BENEFITS**

Legg Mason, through its subsidiaries, maintains various defined contribution plans covering substantially all employees. Through its primary plan, Legg Mason can make two types of discretionary contributions. One is a profit sharing contribution to eligible Plan participants based on a percentage of qualified compensation and the other is a 50% match of employee 401(k) contributions up to 6% of employee compensation with a maximum of five thousand dollars per year. Profit sharing and matching contributions amounted to \$22,739 and \$18,199 in fiscal 2011 and 2010, respectively. Matching contributions amounted to \$14,366 in fiscal 2009. Legg Mason elected to not make a profit sharing contribution in fiscal 2009. In addition, employees can make voluntary contributions under certain plans.

## **11. CAPITAL STOCK**

At March 31, 2011, the authorized numbers of common, preferred and exchangeable shares were

500,000, 4,000 and an unlimited number, respectively. At March 31, 2011 and 2010, there were 14,557 and 16,377 shares of common stock, respectively, reserved for issuance under Legg Mason's equity plans. As of March 31, 2010, 1,099 common shares were reserved for exchangeable shares issued in connection with the acquisition of Legg Mason Canada Inc. Exchangeable shares were exchangeable at any time by the holder on a one-for-one basis into shares of Legg Mason's common stock and were included in basic shares outstanding. In May 2010, all outstanding exchangeable shares were converted into shares of Legg Mason common stock.

On May 10, 2010, Legg Mason announced that its Board of Directors replaced its existing stock buyback authority with the authority to purchase up to \$1 billion worth of Legg Mason common stock. There is no expiration date attached to this new authorization. During fiscal 2011, Legg Mason entered into separate accelerated share repurchase agreements ("ASR Agreements") with two financial institutions to repurchase, in the aggregate, \$300,000 of Legg Mason common stock. Under the ASR Agreements, Legg Mason received 10,147 shares of its common stock. All shares purchased under the ASR Agreements were retired upon receipt. During fiscal 2011, Legg Mason also purchased and retired 4,405 shares of its common stock in the open market for \$145,067. The remaining balance of the authorized stock buyback is \$554,933.

As discussed in Note 7, in May 2008, Legg Mason issued \$1,150,000 of Equity Units, each unit consisting of a 5% interest in one thousand dollar principal amount of senior notes due June 30, 2021, and a purchase contract committing the holder to purchase shares of Legg Mason's common stock by June 30, 2011. During fiscal 2010, Legg Mason issued approximately 18,596 shares through the Equity Unit tender offer in exchange for 91% of the outstanding Equity Units. As of March 31, 2011, the maximum amount of shares that could be issued, and are reserved for issuance, is approximately 1,830, subject to adjustment. Also discussed in Note 7, in January 2008, Legg Mason issued \$1,250,000 of 2.5% contingent convertible senior notes, which, if certain conditions are met, could result in the issuance of a maximum of approximately 14,205 shares of Legg Mason common stock, subject to adjustment.

Changes in common stock and shares exchangeable into common stock for the three years ended March 31, 2011, 2010 and 2009 are as follows:

	Years Ended March 31,		
	2011	2010	2009
<b>COMMON STOCK</b>			
Beginning balance	161,439	141,853	138,556
Shares issued for:			
Stock option exercises and other stock-based compensation	638	72	1,094
Deferred compensation trust	75	133	155
Deferred compensation	1,520	662	922
Exchangeable shares	1,099	123	761
Shares repurchased and retired	(14,552)	—	—
Conversion of non-voting preferred stock	—	—	365
Equity Units exchange	—	18,596	—
Ending balance	150,219	161,439	141,853
<b>SHARES EXCHANGEABLE INTO COMMON STOCK</b>			
Beginning balance	1,099	1,222	1,983
Exchanges	(1,099)	(123)	(761)
Ending balance	—	1,099	1,222

Dividends declared per share were \$0.20, \$0.12, and \$0.96 for fiscal 2011, 2010 and 2009, respectively. Dividends declared but not paid at March 31, 2011, 2010 and 2009 were \$8,990, \$4,844, and \$34,043, respectively, and are included in Other current liabilities.

## 12. 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. Effective July 28, 2009, the number of shares authorized to be issued under Legg Mason's active equity incentive stock plan was increased by

6,000 to 35,000. Shares available for issuance as of March 31, 2011 were 8,304. 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 three to five years and expire within five to ten years from the date of grant.

Compensation expense relating to stock options for the years ended March 31, 2011, 2010, and 2009 was \$19,926, \$17,281, and \$22,224, respectively. The related income tax benefit for the years ended March 31, 2011, 2010, and 2009 was \$7,718, \$6,221, and \$8,710, respectively.

Stock option transactions under Legg Mason's equity incentive plans during the years ended March 31, 2011, 2010, and 2009, respectively, are summarized below:

	Number of Shares	Weighted-Average Exercise Price Per Share
Options outstanding at March 31, 2008	5,847	\$65.81
Granted	1,496	29.54
Exercised	(1,131)	24.90
Canceled/forfeited	(658)	68.24
Options outstanding at March 31, 2009	5,554	\$64.09
Granted	1,457	26.82
Exercised	(72)	25.40
Canceled/forfeited	(885)	49.24
Options outstanding at March 31, 2010	6,054	\$57.75
Granted	729	33.12
Exercised	(634)	21.85
Canceled/forfeited	(730)	48.94
<b>Options outstanding at March 31, 2011</b>	<b>5,419</b>	<b>\$59.82</b>

The total intrinsic value of options exercised during the years ended March 31, 2011, 2010, and 2009 was \$6,977, \$229, and \$11,102, respectively. At March 31, 2011, the aggregate intrinsic value of options outstanding was \$17,010.

The following information summarizes Legg Mason's stock options outstanding at March 31, 2011:

Exercise Price Range	Option Shares Outstanding	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Life (in years)
\$ 12.65–\$ 25.00	114	\$ 15.61	5.4
25.01– 35.00	2,792	30.83	6.0
35.01– 94.00	482	52.40	1.2
94.01– 100.00	583	95.17	3.3
100.01– 134.97	1,448	107.42	3.2
	<u>5,419</u>		

At March 31, 2011, 2010, and 2009, options were exercisable on 2,860, 2,810, and 2,811 shares, respectively, and the weighted-average exercise prices were \$77.20, \$73.57, and \$64.64, respectively. Stock options exercisable at March 31, 2011 have a weighted-average remaining contractual life of 3.3 years. At March 31, 2011, the aggregate intrinsic value of options exercisable was \$4,207.

The following information summarizes Legg Mason's stock options exercisable at March 31, 2011:

Exercise Price Range	Option Shares Exercisable	Weighted-Average Exercise Price Per Share
\$ 12.65–\$ 25.00	42	\$ 15.69
25.01– 35.00	679	31.16
35.01– 94.00	482	52.40
94.01– 100.00	473	95.16
100.01– 134.97	1,184	108.72
	<u>2,860</u>	

The following information summarizes unvested stock options under Legg Mason's equity incentive plans for the year ended March 31, 2011:

	Number of Shares	Weighted-Average Grant Date Fair Value
Shares unvested at		
March 31, 2010	3,245	\$17.04
Granted	729	14.32
Vested <sup>(1)</sup>	(992)	18.56
Canceled/forfeited	(423)	15.78
<b>Shares unvested at</b>		
<b>  March 31, 2011</b>	<b>2,559</b>	<b>\$15.89</b>

(1) Stock options granted prior to fiscal 2011 vest in July each year; beginning in fiscal 2011, stock options granted vest in May each year.

Unamortized compensation cost related to unvested options at March 31, 2011 was \$28,207 and is expected to be recognized over a weighted-average period of 1.9 years.

Cash received from exercises of stock options under Legg Mason's equity incentive plans was \$12,094, \$1,829, and \$25,463 for the years ended March 31, 2011, 2010, and 2009, respectively. The tax benefit expected to be realized for the tax deductions from these option exercises totaled \$2,645, \$73, and \$3,889 for the years ended March 31, 2011, 2010, and 2009, respectively.

The weighted-average fair value of stock options granted in fiscal 2011, 2010, and 2009, using the Black-Scholes option-pricing model, was \$14.32, \$12.09, and \$13.36 per share, respectively.

The following weighted-average assumptions were used in the model for grants in fiscal 2011, 2010, and 2009:

	2011	2010	2009
Expected dividend yield	<b>1.39%</b>	1.45%	0.89%
Risk-free interest rate	<b>2.37%</b>	2.86%	3.46%
Expected volatility	<b>52.64%</b>	55.26%	56.65%
Expected lives (in years)	<b>5.18</b>	5.17	5.28

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

Legg Mason has a qualified Employee Stock Purchase Plan covering substantially all U.S. employees. Shares of common stock are purchased in the open market on behalf of participating employees, subject to a 4,500 total share limit under the plan. Purchases are made through payroll deductions and Legg Mason provides a 10% contribution towards purchases, which is charged to earnings. During the fiscal years ended March 31, 2011, 2010, and 2009, approximately 102, 147, and 188 shares, respectively, have been purchased in the open market on behalf of participating employees. In fiscal 2011, 2010, and 2009, Legg Mason recognized \$286, \$313, and \$418, respectively, in compensation expense related to the stock purchase plan.

On January 28, 2008, the Compensation Committee of Legg Mason approved grants to senior officers of 120 market-based performance shares that upon vesting, subject to certain conditions, are distributed as shares of common stock. The grants will vest ratably on January 28 of each of the five years following the grant date, upon attaining the service criteria and the stock price hurdles beginning at \$77.97 in year one and ending at \$114.15 in year five.

The weighted-average fair value per share for these awards of \$11.81 was estimated as of the grant date using a grant price of \$70.88, and a Monte Carlo option-pricing model with the following assumptions:

Expected dividend yield	1.33%
Risk-free interest rate	3.30%
Expected volatility	36.02%

In connection with the termination of a senior officer in fiscal 2009, 20 performance shares were voluntarily forfeited, resulting in a charge of \$550 representing an acceleration of expense associated with the unvested portion of the award.

Restricted stock and restricted stock unit transactions during the years ended March 31, 2011, 2010, and 2009, respectively, are summarized below:

	Number of Shares	Weighted-Average Grant Date Value
Unvested Shares at March 31, 2008	642	\$ 98.30
Granted	997	34.69
Vested	(257)	100.76
Canceled/forfeited	(41)	78.82
Unvested Shares at March 31, 2009	1,341	51.26
Granted	786	22.35
Vested	(467)	58.83
Canceled/forfeited	(55)	53.37
Unvested Shares at March 31, 2010	1,605	34.80
Granted	1,867	33.02
Vested	(617)	38.62
Canceled/forfeited	(218)	30.42
<b>Unvested Shares at March 31, 2011</b>	<b>2,637</b>	<b>\$ 33.01</b>

The restricted stock and restricted stock unit awards were non-cash transactions. In fiscal 2011, 2010, and 2009, Legg Mason recognized \$35,770, \$27,233, and \$32,629, respectively, in compensation expense and related tax benefits of \$13,854, \$9,804, and \$12,787, respectively, for restricted stock and restricted stock unit awards. Unamortized compensation cost related to unvested restricted stock and restricted stock unit awards for 2,637 shares not yet recognized at March 31, 2011 was \$53,393 and is expected to be recognized over a weighted-average period of 1.8 years.

Legg Mason also has an equity plan for non-employee directors. Under the equity plan, directors may elect to receive shares of stock or restricted stock units. Prior to a July 19, 2007 amendment to the Plan, directors could also elect to receive stock options. Options granted under the old plan are immediately exercisable at a price equal to the market value of the shares on the date of grant and have a term of not more than ten years. In fiscal 2011, 2010, and 2009, Legg Mason recognized expense of \$1,425, \$1,575, and \$1,400, respectively, for awards under this plan. Shares, options, and restricted stock units issuable under the equity plan are limited to 625 shares in aggregate, of which 232 shares were issued under the plan as of March 31, 2011. At March 31, 2011, non-employee directors held 220 stock options, which are included in the outstanding options presented in the table above. As of March 31, 2011, non-employee directors held 62 restricted stock units, 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. There were 9 stock options

exercised and 7 restricted stock units distributed during fiscal 2011. There were 17 restricted stock units and 31 shares of common stock granted during fiscal 2011. There were 59 stock options and no restricted stock units cancelled or forfeited during fiscal 2011.

Deferred compensation payable in shares of Legg Mason common stock has been granted to certain employees in an elective plan. The vesting in the plan is immediate and the plan provides for discounts of up to 10% on contributions and dividends. There is no limit on the number of shares authorized to be issued under the plan. In fiscal 2011, 2010, and 2009, Legg Mason recognized \$263, \$176, and \$322, respectively, in compensation expense related to this plan. During fiscal 2011, 2010, and 2009, Legg Mason issued 77, 128, and 125 shares, respectively, under the plan with a weighted-average fair value per share at the grant date of \$28.38, \$22.53, and \$39.62, respectively.

Legg Mason has issued shares in connection with certain deferred compensation plans that are held in rabbi trusts. Assets of rabbi trusts are consolidated with those of the employer, and the value of the employer's stock held in the rabbi trusts is classified in stockholders' equity and accounted for in a manner similar to treasury stock. Therefore, the shares Legg Mason has issued to its rabbi trusts and the corresponding liability related to the deferred compensation plans are presented as components of stockholders' equity as Employee stock trust and Deferred compensation employee stock trust, respectively. Shares held by the trusts at March 31, 2011, and 2010 were 3,196 and 2,205, respectively.



As part of the Company's restructuring initiative further discussed in Note 16, the employment of certain recipients of stock option and restricted stock awards will be terminated. The termination benefits extended to these employees include accelerated vesting of any portion of their equity incentive awards that would not have vested by January 1, 2012 under the original terms of the awards. During fiscal 2011, the portion of the awards subject to accelerated vesting were revalued and are being expensed over the new vesting period, the impact of which is included above. Also in connection with the restructuring initiative, the departure of an executive officer in December 2010 resulted in the accelerated vesting of a portion of certain equity incentive awards, the impact of which is also included above.

### 13. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing Net income or 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 potential common shares except when inclusion is antidilutive. In situations where a net loss 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 fiscal 2011, Legg Mason purchased and retired 14,552 shares of its common stock through ASR agreements and open market purchases, of which, 9,088 shares were excluded from weighted-average shares outstanding for the year ended March 31, 2011.

In August 2009, Legg Mason issued 18,596 shares of common stock through the Equity Units tender offer, such that 11,565 shares are included in the weighted-average shares outstanding for the year ended March 31, 2010.

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

	Years Ended March 31		
	2011	2010	2009
Weighted-average basic shares outstanding	155,321	153,715	140,669
Potential common shares:			
Employee stock options	163	56	—
Shares related to deferred compensation	—	455	—
Shares issuable upon payment of contingent consideration	—	1,136	—
Weighted-average diluted shares	155,484	155,362	140,669
Net income (loss)	\$245,763	\$210,980	\$(1,964,994)
Less: Net income (loss) attributable to noncontrolling interests	(8,160)	6,623	2,924
Net income (loss) attributable to Legg Mason, Inc.	\$253,923	\$204,357	\$(1,967,918)
Net income (loss) per share attributable to Legg Mason, Inc. common shareholders:			
Basic	\$ 1.63	\$ 1.33	\$ (13.99)
Diluted	\$ 1.63	\$ 1.32	\$ (13.99)

The diluted EPS calculations for the years ended March 31, 2011 and 2010, exclude any potential common shares issuable under the convertible 2.5% senior notes or the convertible Equity Units because the market price of Legg Mason common stock has not exceeded the price at which conversion under either instrument would be dilutive using the treasury stock method. Also, the diluted EPS calculation for the fiscal year ended March 31, 2009 excludes 6,629 potential common shares that are antidilutive due to the net loss for the fiscal year.

Options to purchase 5,204 shares and 5,130 shares for the fiscal years ended March 31, 2011 and 2010, 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 fiscal year and therefore the options are deemed antidilutive. Also at March 31, 2011, 2010, and 2009, warrants issued in connection with the convertible note hedge transactions described in Note 7 are excluded from the calculation of diluted earnings per

share because the effect would be antidilutive. As of March 31, 2011, 2,061 of the 23,000 Equity Units issued in May 2008, that include purchase warrants providing for the issuance of between 1,525 and 1,830 shares of Legg Mason common stock by June 2011, remain outstanding, as more fully described in Note 7.

#### 14. ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income includes cumulative foreign currency translation adjustments and net of tax gains and losses on investment

securities. The change in the accumulated translation adjustments for fiscal 2011 and 2010 primarily resulted from the impact of changes in the Brazilian real, the Japanese yen, the British pound, Singapore dollar, and the Australian dollar in relation to the U.S. dollar on the net assets of Legg Mason's subsidiaries in Brazil, Japan, the United Kingdom, Singapore, and Australia, for which the real, the yen, the pound, the Singapore dollar and the Australian dollar are the functional currencies, respectively.

A summary of Legg Mason's accumulated other comprehensive income as of March 31, 2011 and 2010 is as follows:

	2011	2010
Foreign currency translation adjustments	<b>\$93,302</b>	\$58,143
Unrealized gains on investment securities, net of tax provision of \$39 and \$56, respectively	<b>59</b>	84
Total	<b>\$93,361</b>	\$58,227

#### 15. DERIVATIVES AND HEDGING

The disclosures below detail Legg Mason's derivatives and hedging excluding the derivatives and hedging of CIVs. See Note 18, Variable Interest Entities and Consolidation of Investment Vehicles, for information related to the derivatives and hedging of CIVs.

Legg Mason continues to use currency forwards to economically hedge the risk of movements in exchange rates, primarily between the U.S. dollar, euro, Great Britain pound, Canadian dollar, Japanese yen, Singapore dollar, and Brazilian real. 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 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 \$7,099 and \$2,185, as of March 31, 2011 and 2010, respectively.

The following table presents the fair value as of March 31, 2011 and 2010 of derivative instruments not designated as hedging instruments, classified as Other assets and Other liabilities:

	2011		2010	
	Assets	Liabilities	Assets	Liabilities
Currency forward contracts	<b>\$1,112</b>	<b>\$1,633</b>	\$671	\$255
Futures contracts	<b>57</b>	<b>1,487</b>	26	230
Total	<b>\$1,169</b>	<b>\$3,120</b>	\$697	\$485

The following table presents gains (losses) recognized on derivative instruments for the years ended March 31, 2011 and 2010:

	Income Statement Classification	2011		2010	
		Gains	Losses	Gains	Losses
Currency forward contracts for:					
Operating activities	Other expense	<b>\$4,943</b>	<b>\$ (6,094)</b>	\$5,669	\$(11,092)
Seed capital investments	Other non-operating income (expense)	<b>123</b>	<b>(355)</b>	269	(19)
Futures contracts	Other non-operating income (expense)	<b>1,652</b>	<b>(7,146)</b>	26	(1,081)
Total		<b>\$6,718</b>	<b>\$(13,595)</b>	\$5,964	\$(12,192)

## 16. RESTRUCTURING

In May 2010, Legg Mason announced a plan to streamline its business model to drive increased profitability and growth that includes: 1) transitioning certain shared services to its investment affiliates which are closer to the actual client relationships; and 2) sharing in affiliate revenue with its Americas distribution group. This plan involves headcount reductions in operations, technology, and other administrative areas, which may be partially offset by headcount increases at the affiliates, and will ultimately enable Legg Mason to eliminate a portion of its corporate office space that was dedicated to operations and technology employees. Legg Mason expects the initiative to be substantially complete in fiscal 2012.

This initiative involves transition-related costs primarily comprised of charges for employee termination benefits and retention incentives during the transition period, recorded in Transition-related compensation. The transition-related costs also involve other costs, including charges for consolidating leased office space, early contract terminations, asset disposals, and professional fees, recorded in the appropriate operating expense classifications. Total transition-related costs are expected to be in the range of \$115,000 to \$135,000. Charges for transition-related costs were \$54,434 for the year ended March 31, 2011, which primarily represent costs for severance and retention incentives. Substantially all of the remaining costs will be accrued in fiscal 2012.

The table below presents a summary of changes in the transition-related liability from March 31, 2010 through March 31, 2011 and cumulative charges incurred through March 31, 2011, including non-cash charges, such as asset write-offs:

	Balance as of March 31, 2010	Accrued charges	Payments	Balance as of March 31, 2011	Other Non-cash Charges <sup>(1)</sup>	Cumulative Charges
Severance and retention incentives	\$—	\$35,487	\$(12,276)	<b>\$23,211</b>	\$ 9,561	\$45,048
Other	—	6,160	(325)	<b>5,835</b>	3,226	9,386
	\$—	\$41,647	\$(12,601)	<b>\$29,046</b>	\$12,787	\$54,434

(1) Includes stock-based compensation expense, write-offs of capitalized costs, primarily for internally-developed software, that will no longer be utilized as a result of the initiative.

The estimates for remaining transition-related costs are as follows:

	Minimum	Maximum
Severance and retention incentives	\$32,000	\$46,000
Other costs	29,000	35,000
Total	\$61,000	\$81,000

While management expects the total estimated costs to be within the range disclosed, the nature of the costs may differ from those presented above.

## 17. BUSINESS SEGMENT INFORMATION

Legg Mason is a global asset management company that provides investment management and related services to a wide array of clients. The Company operates in one reportable business segment, Asset Management. Asset Management provides investment advisory services to institutional and individual clients and to company-sponsored investment funds. The primary sources of revenue in Asset Management are investment advisory, distribution and administrative fees, which typically are calculated as a percentage of the AUM and vary based upon factors such as the type

of underlying investment product and the type of services that are provided. In addition, performance fees may be earned on certain investment advisory contracts for exceeding performance benchmarks.

Legg Mason operates through two operating segments (divisions), Americas and International, which are primarily based on the geographic location of the advisor or the domicile of fund families we manage. The Americas Division consists of our U.S.-domiciled fund families, the separate account businesses of our U.S.-based investment affiliates and the domestic distribution organization. Similarly, the International Division consists of our fund complexes, distribution teams and investment affiliates located outside the U.S., primarily in the United Kingdom.

In December 2010, Legg Mason announced a realignment of its executive management team which, among other things, will eliminate the previous separation of the Americas and International divisions into one Global Asset Management business during fiscal 2012. Although the executive management

realignment was announced in fiscal 2011, as of March 31, 2011, no changes had been made to the internal reporting practices and Legg Mason continued to operate in one reportable business segment, Asset Management, with two divisions, Americas and International.

The table below reflects our revenues and long-lived assets by geographic region (in thousands) as of March 31:

	2011	2010	2009
<b>OPERATING REVENUES</b>			
United States	<b>\$1,919,680</b>	\$1,866,909	\$2,290,474
United Kingdom	<b>512,313</b>	478,510	747,257
Other International	<b>352,324</b>	289,460	319,636
Total	<b>\$2,784,317</b>	\$2,634,879	\$3,357,367
<b>INTANGIBLE ASSETS, NET AND GOODWILL</b>			
United States	<b>\$3,565,019</b>	\$3,590,283	\$3,606,678
United Kingdom	<b>1,136,386</b>	1,139,065	1,052,007
Other International	<b>487,022</b>	488,170	450,863
Total	<b>\$5,188,427</b>	\$5,217,518	\$5,109,548

#### 18. VARIABLE INTEREST ENTITIES AND CONSOLIDATION OF INVESTMENT VEHICLES

Legg Mason is the investment manager for CDOs/CLOs that are considered VIEs under new accounting guidance, since investors in these structures lack unilateral decision making authority. These investment vehicles were created for the sole purpose of issuing collateralized instruments that offer investors the opportunity for returns that vary with the risk level of their investment. Legg Mason's management fee structure for these investment vehicles typically includes a senior management fee, and may also include subordinated and incentive management fees. Legg Mason holds no equity interest in any of these investment vehicles and did not sell or transfer any assets to any of these investment vehicles. In accordance with the methodology described in Note 1 above, Legg Mason concluded that its collateral management agreements represent a variable interest in only two of these investment vehicles, which are CLOs, primarily due to the level of subordinated fees. After considering the factors described in Note 1 above, Legg Mason concluded that it is the primary beneficiary of one of the two CLOs, which resulted in its consolidation into Legg Mason's financial statements as of April 1, 2010. The collateral assets

of this VIE are primarily comprised of investments in corporate loans and, to a lesser extent, bonds. The assets of the CLO cannot be used by Legg Mason and gains and losses related to these assets have no impact on Net Income Attributable to Legg Mason, Inc. The liabilities of this VIE are primarily comprised of debt and the CLO's debt holders have recourse only to the assets of the CLO and have no recourse to the general credit or assets of Legg Mason.

In addition, Legg Mason was the primary beneficiary of one sponsored investment fund VIE and held a controlling financial interest in two sponsored investment fund VREs, all of which were consolidated as of March 31, 2011. As of March 31, 2010, Legg Mason consolidated the sponsored investment fund VIE and one of the sponsored investment fund VREs. Legg Mason's investment in the CIVs as of March 31, 2011 and March 31, 2010 was \$53,708 and \$61,864, 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 March 31, 2011 and March 31, 2010 and the Consolidated Statements of Income for the fiscal year ended March 31, 2011 and 2010, respectively:

### Consolidating Balance Sheets

March 31, 2011				
	Balance Before Consolidation of CIVs	CIVs	Eliminations	As Reported
Current assets	\$2,378,226	\$122,963	\$(54,633)	\$2,446,556
Non-current assets	5,946,737	314,463	—	6,261,200
<b>Total assets</b>	<b>\$8,324,963</b>	<b>\$437,426</b>	<b>\$(54,633)</b>	<b>\$8,707,756</b>
Current liabilities	\$ 914,803	\$ 55,094	\$ (925)	\$ 968,972
Long-term debt of CIVs	—	278,320	—	278,320
Other non-current liabilities	1,649,815	3,553	—	1,653,368
<b>Total liabilities</b>	<b>2,564,618</b>	<b>336,967</b>	<b>(925)</b>	<b>2,900,660</b>
Redeemable non-controlling interests	976	—	35,736	36,712
<b>Total stockholders' equity</b>	<b>5,759,369</b>	<b>100,459</b>	<b>(89,444)</b>	<b>5,770,384</b>
<b>Total liabilities and equity</b>	<b>\$8,324,963</b>	<b>\$437,426</b>	<b>\$(54,633)</b>	<b>\$8,707,756</b>

March 31, 2010				
	Balance Before Consolidation of CIVs	CIVs	Eliminations	As Reported
Current assets	\$2,541,880	\$ 79,692	\$(62,426)	\$2,559,146
Non-current assets	6,049,794	13,692	—	6,063,486
<b>Total assets</b>	<b>\$8,591,674</b>	<b>\$ 93,384</b>	<b>\$(62,426)</b>	<b>\$8,622,632</b>
Current liabilities	\$1,053,893	\$ 961	\$ (578)	\$1,054,276
Long-term debt of CIVs	—	—	—	—
Other non-current liabilities	1,697,055	—	—	1,697,055
<b>Total liabilities</b>	<b>2,750,948</b>	<b>961</b>	<b>(578)</b>	<b>2,751,331</b>
Redeemable non-controlling interests	667	—	28,910	29,577
<b>Total stockholders' equity</b>	<b>5,840,059</b>	<b>92,423</b>	<b>(90,758)</b>	<b>5,841,724</b>
<b>Total liabilities and equity</b>	<b>\$8,591,674</b>	<b>\$ 93,384</b>	<b>\$(62,426)</b>	<b>\$8,622,632</b>



## Consolidating Statements of Income

	Fiscal Year Ended March 31, 2011			
	Balance Before Consolidation of CIVs	CIVs	Eliminations	As Reported
Total operating revenues	\$ 2,788,450	\$ —	\$ (4,133)	\$ 2,784,317
Total operating expenses	2,396,938	4,704	(4,133)	2,397,509
Operating income (loss)	391,512	(4,704)	—	386,808
Total other non-operating income (expense)	(17,931)	1,704	(5,384)	(21,611)
Income (loss) before income tax provision	373,581	(3,000)	(5,384)	365,197
Income tax provision	119,434	—	—	119,434
Net income (loss)	254,147	(3,000)	(5,384)	245,763
Less: Net income (loss) attributable to noncontrolling interests	224	—	(8,384)	(8,160)
Net income (loss) attributable to Legg Mason, Inc.	\$ 253,923	\$ (3,000)	\$ 3,000	\$ 253,923

	Fiscal Year Ended March 31, 2010			
	Balance Before Consolidation of CIVs	CIVs	Eliminations	As Reported
Total operating revenues	\$ 2,637,658	\$ —	\$ (2,779)	\$ 2,634,879
Total operating expenses	2,314,376	2,263	(2,943)	2,313,696
Operating income (loss)	323,282	(2,263)	164	321,183
Total other non-operating income (expense)	(47)	17,329	(8,809)	8,473
Income (loss) before income tax provision	323,235	15,066	(8,645)	329,656
Income tax provision	118,676	—	—	118,676
Net income (loss)	204,559	15,066	(8,645)	210,980
Less: Net income (loss) attributable to noncontrolling interests	202	—	6,421	6,623
Net income (loss) attributable to Legg Mason, Inc.	\$ 204,357	\$15,066	\$(15,066)	\$ 204,357

	Fiscal Year Ended March 31, 2009			
	Balance Before Consolidation of CIVs	CIVs	Eliminations	As Reported
Total operating revenues	\$ 3,358,599	\$ —	\$ (1,232)	\$ 3,357,367
Total operating expenses	4,025,842	1,938	(1,233)	4,026,547
Operating income (loss)	(667,243)	(1,938)	1	(669,180)
Total other non-operating income (expense)	(2,523,722)	7,796	(3,091)	(2,519,017)
Income (loss) before income tax provision	(3,190,965)	5,858	(3,090)	(3,188,197)
Income tax benefit	(1,223,203)	—	—	(1,223,203)
Net income (loss)	(1,967,762)	5,858	(3,090)	(1,964,994)
Less: Net income attributable to noncontrolling interests	156	—	2,768	2,924
Net income (loss) attributable to Legg Mason, Inc.	\$(1,967,918)	\$ 5,858	\$ (5,858)	\$(1,967,918)

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 defined in Note 1) as of March 31, 2011 and March 31, 2010:

	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Value as of March 31, 2011
<b>Assets:</b>				
Trading investments:				
Hedge funds	\$ —	\$ 14,087	\$ 34,272	\$ 48,359
Government and corporate securities	—	22,139	—	22,139
Repurchase agreements	—	12,331	—	12,331
Total trading investment securities	—	48,557	34,272	82,829
Investments:				
CLO loans	—	275,948	—	275,948
CLO bonds	—	18,813	—	18,813
Private equity funds	—	—	17,879	17,879
Total investments	—	294,761	17,879	312,640
Derivative assets	125	45	—	170
	\$ 125	\$343,363	\$ 52,151	\$ 395,639
<b>Liabilities:</b>				
CLO debt	\$ —	\$ —	\$(278,320)	\$(278,320)
Reverse repurchase agreements	—	(18,310)	—	(18,310)
Derivative liabilities	(128)	(14,169)	—	(14,297)
	\$(128)	\$ (32,479)	\$(278,320)	\$(310,927)
	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Value as of March 31, 2010
<b>Assets:</b>				
Trading investment securities:				
Hedge funds	\$ —	\$ 24,813	\$ 12,374	\$ 37,187
Investments:				
Private equity funds	—	—	13,692	13,692
	\$ —	\$ 24,813	\$ 26,066	\$ 50,879

The table below presents a summary of changes in assets and (liabilities) of CIVs measured at fair value using significant unobservable inputs (Level 3) for the periods from March 31, 2010 to March 31, 2011 and March 31, 2009 to March 31, 2010:

	Value as of March 31, 2010	Purchases, sales, issuances and settlements, net	Net transfer into/out of Level 3 <sup>(1)</sup>	Realized and unrealized gains/ (losses), net	Value as of March 31, 2011
<b>Assets:</b>					
Hedge funds	\$12,374	\$ 8,340	\$ 5,862	\$ 7,696	<b>\$ 34,272</b>
Private equity funds	13,692	4,906	—	(719)	<b>17,879</b>
	\$26,066	\$13,246	\$ 5,862	\$ 6,977	<b>\$ 52,151</b>
<b>Liabilities:</b>					
CLO debt	\$ —	\$ —	\$(249,668)	\$(28,652)	<b>\$(278,320)</b>
Total realized and unrealized gains (losses), net				\$(21,675)	

	Value as of March 31, 2009	Purchases, sales, issuances and settlements, net	Net transfer into/out of Level 3 <sup>(1)</sup>	Realized and unrealized gains/ (losses), net	Value as of March 31, 2010
<b>Assets:</b>					
Hedge funds	\$ 4,250	\$(3,670)	\$ 10,414	\$ 1,380	\$ 12,374
Private equity funds	4,976	8,716	—	—	13,692
	\$ 9,226	\$ 5,046	\$ 10,414	\$ 1,380	\$ 26,066

(1) Transfers into Level 3 for the fiscal years ended March 31, 2011 and 2010 primarily represent assets and liabilities recorded upon the initial consolidation of investment vehicles.

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 \$(21,668) and \$1,377 for the fiscal year ended March 31, 2011 and 2010, respectively.

There were no significant transfers between Levels 1 and 2 during the year ended March 31, 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 March 31, 2011, the nature of these investments and any related liquidation restrictions or other factors which may impact the ultimate value realized.

Category of Investment	Investment Strategy	Fair Value Determined Using NAV	Unfunded Commitments	Remaining Term
Hedge funds	Global, fixed income, macro, long/short equity, systematic, emerging market, U.S. and Europe hedge	\$45,978 <sup>(1)</sup>	n/a	n/a
Fund-of-hedge funds	Fixed income-emerging market, and Europe hedge	2,381 <sup>(2)</sup>	n/a	n/a
Private equity funds	Long/short equity	17,879 <sup>(3)</sup>	\$11,830	8 years
<b>Total</b>		<b>\$66,238</b>	<b>\$11,830</b>	

n/a—not applicable

(1) 30% quarterly redemption; 1% annual redemption; and 69% subject to three to five year lock-up or side pocket provisions.

(2) Monthly redemption.

(3) Liquidations are expected during the remaining term.

There are no current plans to sell any of these investments.

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 March 31, 2011:

CLO loans and bonds	
Unpaid principal balance	\$299,044
Unpaid principal balance in excess of fair value	(4,283)
Fair value	\$294,761
Unpaid principal balance of loans that are more than 90 days past due and also in nonaccrual status	\$ 4,963
Unpaid principal balance in excess of fair value for loans that are more than 90 days past due and also in nonaccrual status	(2,837)
Fair value of loans more than 90 days past due and in nonaccrual status	\$ 2,126
Debt	
Principal amounts outstanding	\$300,959
Excess unpaid principal over fair value	(22,639)
Fair value	\$278,320

During the year ended March 31, 2011, total net losses of \$14,686 were recognized in Other non-operating income (expense) of CIVs in the Consolidated Statements of Income related to assets and liabilities for which the fair value option was elected. For CLO loans and CLO debt measured at fair value, substantially all of the estimated gains and losses included in earnings for the year ended March 31, 2011 were attributable to instrument specific credit risk as relevant interest rates were fairly static while the credit spreads for these instruments widened during the current period, particularly credit spreads for the CLO debt with lower seniority in the capital structure.

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.

As of March 31, 2011, total derivative assets and liabilities of CIVs of \$170 and \$14,297, respectively, are primarily recorded in Other liabilities of CIVs. Gains and (losses) of \$15,364 and \$(18,022), respectively, for the fiscal year ended March 31, 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 March 31, 2011 and March 31, 2010, for VIEs in which Legg Mason holds a significant 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 March 31, 2011				
	VIE Assets Not Consolidated	VIE Liabilities Not Consolidated	Equity Interests on the Consolidated Balance Sheet	Maximum Risk of Loss <sup>(2)</sup>
<b>CDOs/CLOs<sup>(1)</sup></b>	<b>\$ 382,692</b>	<b>\$ 354,692</b>	<b>\$ —</b>	<b>\$ 196</b>
<b>Public-Private Investment Program<sup>(3)</sup></b>	<b>692,488</b>	<b>2,002</b>	<b>290</b>	<b>290</b>
<b>Other sponsored investment funds</b>	<b>20,241,752</b>	<b>16,771</b>	<b>83,480</b>	<b>121,899</b>
<b>Total</b>	<b>\$21,316,932</b>	<b>\$ 373,465</b>	<b>\$ 83,770</b>	<b>\$122,385</b>

As of March 31, 2010				
	VIE Assets Not Consolidated	VIE Liabilities Not Consolidated	Equity Interests on the Consolidated Balance Sheet	Maximum Risk of Loss <sup>(2)</sup>
CDOs/CLOs <sup>(1)</sup>	\$ 3,508,290	\$3,215,890	\$ —	\$ —
Public-Private Investment Program <sup>(3)</sup>	411,489	—	55,526	72,245
Other sponsored investment funds	16,564,227	1,334	47,484	71,383
Total	\$20,484,006	\$3,217,224	\$103,010	\$143,628

(1) Legg Mason manages certain CDOs/CLOs in which it is no longer considered to have a variable interest under new accounting guidance effective April 1, 2010. The aggregate cumulative assets and liabilities of these CDOs/CLOs were \$2,817,357 and \$2,577,457, respectively, as of March 31, 2010.

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

(3) The Company continues to manage funds under the Public-Private Investment Program. As a result of restructuring its investment during the three months ended June 30, 2010, the Company remains a sponsor but no longer has a variable interest in certain of the Public-Private Investment Program funds.

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.

## 19. LIQUIDITY FUND SUPPORT

Due to stress in the liquidity markets in prior years, certain asset backed securities previously held by liquidity funds that a Legg Mason subsidiary manages were in default or had been restructured after a default. Although the Company was not required to provide support to the funds, Legg Mason elected to do so to maintain the confidence of its clients, maintain its reputation in the marketplace, and in certain cases, support the AAA/Aaa credit ratings of funds. If clients were to lose confidence in the Company, they could potentially withdraw funds in favor of investments offered by competitors, resulting in a reduction in Legg Mason's assets under management and investment advisory and other fees.

As of March 31, 2010, all previously existing support arrangements had expired or were terminated in accordance with their terms. For the year ended March 31, 2010, Legg Mason recognized pre-tax gains of \$23,171

(\$16,565 net of income taxes), which represents the reversal of unrealized, non-cash losses recorded in fiscal 2009 related to four CSAs to support investments in non-asset backed securities. This amount also includes pre-tax gains on foreign exchange forward contracts of \$1,484 and an interest payment of \$1,056 received related to SIV securities that were sold in fiscal 2009.

During fiscal 2009, Legg Mason purchased for \$2,923,666 in cash, including \$24,256 of accrued interest, \$2,972,772 in principal amount of non-bank sponsored SIV securities from six liquidity funds that were previously supported under CSAs and LOCs. The Company subsequently sold the purchased securities, along with \$354,934 of securities previously supported by a TRS and \$76,237 of Canadian conduit securities held on its balance sheet, to third parties for \$654,726, excluding transaction costs. Legg Mason also paid \$181,183 to reimburse two funds for a portion of losses they incurred in selling unsupported SIV securities. As a result of the sale and reimbursement to the funds, which completely eliminated the Company's exposure to securities issued by SIVs, the Company incurred a realized loss of \$2,261,365 (\$1,362,146 net of taxes and operating expense adjustments) in fiscal 2009. Also,



during fiscal 2009, Legg Mason recognized unrealized losses of \$21,871 (\$14,433 net of taxes and operating expense adjustments) related to non-bank sponsored SIV securities purchased from a liquidity fund in fiscal 2008 and unrealized losses related to the four CSAs to support investments in non-asset backed securities,

which expired or were terminated in accordance with their terms during fiscal 2010.

All gains and losses, including interest payments and those related to foreign exchange forward contracts, are included in Fund support in Other non-operating income (expense) on the Consolidated Statements of Income.

# Quarterly Financial Data

(Dollars in thousands, except per share amounts)  
(Unaudited)

Fiscal 2011 <sup>(1)</sup>	Quarter Ended			
	Mar. 31	Dec. 31	Sept. 30	Jun. 30
<b>Operating Revenues</b>	<b>\$713,430</b>	<b>\$721,928</b>	<b>\$674,794</b>	<b>\$674,165</b>
<b>Operating Expenses</b>	<b>614,290</b>	<b>624,936</b>	<b>586,895</b>	<b>571,388</b>
<b>Operating Income</b>	<b>99,140</b>	<b>96,992</b>	<b>87,899</b>	<b>102,777</b>
<b>Other Non-Operating Income (Expense)</b>	<b>3,486</b>	<b>(9,836)</b>	<b>15,409</b>	<b>(30,670)</b>
<b>Income before Income Tax Provision</b>	<b>102,626</b>	<b>87,156</b>	<b>103,308</b>	<b>72,107</b>
<b>Income tax provision</b>	<b>31,858</b>	<b>33,792</b>	<b>26,720</b>	<b>27,064</b>
<b>Net Income</b>	<b>70,768</b>	<b>53,364</b>	<b>76,588</b>	<b>45,043</b>
<b>Less: Net income (loss) attributable to noncontrolling interests</b>	<b>1,731</b>	<b>(8,256)</b>	<b>1,253</b>	<b>(2,888)</b>
<b>Net Income attributable to Legg Mason, Inc.</b>	<b>\$ 69,037</b>	<b>\$ 61,620</b>	<b>\$ 75,335</b>	<b>\$ 47,931</b>
<b>Net Income per Share attributable to Legg Mason, Inc. common shareholders:</b>				
<b>Basic</b>	<b>\$ 0.45</b>	<b>\$ 0.41</b>	<b>\$ 0.50</b>	<b>\$ 0.30</b>
<b>Diluted</b>	<b>0.45</b>	<b>0.41</b>	<b>0.50</b>	<b>0.30</b>
<b>Cash dividend per share</b>	<b>0.06</b>	<b>0.06</b>	<b>0.04</b>	<b>0.04</b>
<b>Stock price range:</b>				
<b>High</b>	<b>37.29</b>	<b>37.72</b>	<b>31.04</b>	<b>34.83</b>
<b>Low</b>	<b>32.21</b>	<b>29.68</b>	<b>24.94</b>	<b>27.36</b>
<b>Assets Under Management:</b>				
<b>End of period</b>	<b>\$677,646</b>	<b>\$671,799</b>	<b>\$673,467</b>	<b>\$645,362</b>
<b>Average</b>	<b>673,495</b>	<b>672,399</b>	<b>658,585</b>	<b>668,268</b>

(1) Due to rounding of quarterly results, total amounts for each fiscal year may differ immaterially from the annual results.

As of May 20, 2011, the closing price of Legg Mason's common stock was \$33.55.

Fiscal 2010 <sup>(1)</sup>	Quarter Ended			
	Mar. 31	Dec. 31	Sept. 30	Jun. 30
<b>Operating Revenues</b>	<b>\$671,420</b>	<b>\$690,479</b>	<b>\$659,896</b>	<b>\$613,084</b>
<b>Operating Expenses</b>	<b>565,584</b>	<b>611,331</b>	<b>582,012</b>	<b>554,769</b>
<b>Operating Income</b>	<b>105,836</b>	<b>79,148</b>	<b>77,884</b>	<b>58,315</b>
<b>Other Non-Operating Income (Expense)</b>	<b>(4,116)</b>	<b>(6,909)</b>	<b>(2,891)</b>	<b>22,389</b>
<b>Income before Income Tax Provision</b>	<b>101,720</b>	<b>72,239</b>	<b>74,993</b>	<b>80,704</b>
<b>Income tax provision</b>	<b>36,619</b>	<b>26,006</b>	<b>27,671</b>	<b>28,380</b>
<b>Net Income</b>	<b>65,101</b>	<b>46,233</b>	<b>47,322</b>	<b>52,324</b>
<b>Less: Net income attributable to noncontrolling interests</b>	<b>1,494</b>	<b>1,311</b>	<b>1,548</b>	<b>2,270</b>
<b>Net Income attributable to Legg Mason, Inc.</b>	<b>\$ 63,607</b>	<b>\$ 44,922</b>	<b>\$ 45,774</b>	<b>\$ 50,054</b>
<b>Net Income per Share attributable to Legg Mason, Inc. common shareholders:</b>				
<b>Basic</b>	<b>\$ 0.40</b>	<b>\$ 0.28</b>	<b>\$ 0.30</b>	<b>\$ 0.35</b>
<b>Diluted</b>	<b>0.39</b>	<b>0.28</b>	<b>0.30</b>	<b>0.35</b>
<b>Cash dividend per share</b>	<b>0.03</b>	<b>0.03</b>	<b>0.03</b>	<b>0.03</b>
<b>Stock price range:</b>				
<b>High</b>	<b>31.95</b>	<b>33.70</b>	<b>33.08</b>	<b>26.74</b>
<b>Low</b>	<b>24.00</b>	<b>26.99</b>	<b>22.06</b>	<b>15.53</b>
<b>Assets Under Management:</b>				
<b>End of period</b>	<b>\$684,549</b>	<b>\$681,614</b>	<b>\$702,700</b>	<b>\$656,857</b>
<b>Average</b>	<b>681,227</b>	<b>693,254</b>	<b>684,034</b>	<b>647,218</b>

(1) Due to rounding of quarterly results, total amounts for each fiscal year may differ immaterially from the annual results.

## Executive Officers

### Mark R. Fetting

Chairman and Chief Executive Officer

### Peter H. Nachtwey

Senior Executive Vice President and Chief Financial Officer

### Ronald R. Dewhurst

Senior Executive Vice President

### Jeffrey A. Nattans

Executive Vice President

### Thomas P. Lemke

Senior Vice President and General Counsel

### Joseph A. Sullivan

Senior Executive Vice President

## Corporate Data

### Executive Offices

100 International Drive  
Baltimore, Maryland 21202  
(410) 539-0000  
www.leggmason.com

### Form 10-K

Legg Mason's Annual Report on Form 10-K for fiscal 2011, filed with the Securities and Exchange Commission and containing audited financial statements, is available upon request without charge by writing to the Corporate Secretary at the Executive Offices of the Company.

Copies can also be obtained by accessing our website at [www.leggmason.com](http://www.leggmason.com)

### Independent Registered Public Accounting Firm

PricewaterhouseCoopers LLP  
100 E. Pratt Street  
Baltimore, Maryland 21202  
(410) 783-7600  
www.pwc.com

### Transfer Agent

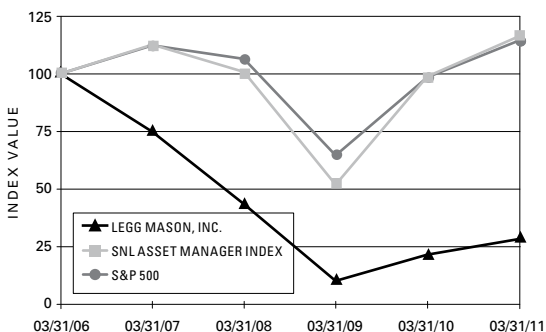
American Stock Transfer & Trust Company  
59 Maiden Lane  
New York, New York 10038  
(866) 668-6550  
www.amstock.com

### Common Stock

Shares of Legg Mason, Inc. common stock are listed and traded on the New York Stock Exchange (symbol: LM). As of March 31, 2011, there were 1,510 shareholders of record of the Company's common stock.

## Total Return Performance

The graph below compares the cumulative total stockholder return on Legg Mason's common stock for the last five fiscal years with the cumulative total return of the S&P 500 Stock Index and the SNL Asset Manager Index over the same period (assuming the investment of \$100 in each on March 31, 2006). The SNL Asset Manager Index consists of 32 asset management firms.



### INDEX

INDEX	PERIOD ENDING					
	03/31/06	03/31/07	03/31/08	03/31/09	03/31/10	03/31/11
Legg Mason, Inc.	100.00	75.79	45.59	13.52	24.48	31.00
SNL Asset Manager Index	100.00	112.13	100.70	53.53	98.79	115.62
S&P 500	100.00	111.83	106.15	65.72	98.43	113.83

Source: SNL Financial LC, Charlottesville, VA  
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## Our commitment to the global communities in which we live and work

Legg Mason strives to enrich the global communities in which our employees live and work. We are committed to sustainability, we support philanthropic and community initiatives and we value diversity and inclusion in our perspectives and our workforce. As proud members of the Baltimore community, where we are headquartered, and through our global offices, we support a diverse network of projects including scholarship sponsorship, mentoring programs, and Days of Caring. Legg Mason has a long history of supporting local and global community efforts philanthropically through the Legg Mason Charitable Foundation, including an emphasis this past year on disaster relief assistance. Our employees are actively engaged in our philanthropic and community outreach efforts and our perspective focuses on our efforts over the long term. We believe that by investing in our communities, we invest in our futures.





# LEGG MASON

GLOBAL ASSET MANAGEMENT



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