LEGG MASON INC
Form 10-Q
November 06, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2009

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number: 1-8529

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

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

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

Yes X No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No X

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

161,337,832 shares of common stock and 1,105,773 exchangeable shares as of the close of business on November 2, 2009. The exchangeable shares, which were issued by a subsidiary of the registrant, are exchangeable at any time into common stock on a one-for-one basis and entitle holders to dividend, voting and other rights equivalent to common stock.

PART I. FINANCIAL INFORMATION

Item 1.

Financial Statements

LEGG MASON, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

(Unaudited)

	September 30, 2009	March 31, 2009
ASSETS		
Current Assets		
Cash and cash equivalents	$ 1,548,107	$ 1,084,474
Restricted cash	22,656	41,688
Receivables:		
Investment advisory and related fees	332,826	293,084
Other	231,358	306,837
Investment securities	386,597	336,092
Refundable income taxes	29,473	603,668
Deferred income taxes	91,330	94,112
Other	58,982	99,432
Total current assets	2,701,329	2,859,387
Fixed assets, net	384,111	367,043
Intangible assets, net	3,913,704	3,922,801
Goodwill	1,301,012	1,186,747
Deferred income taxes	752,154	759,433
Other	144,342	136,888
Total Assets	$ 9,196,652	$ 9,232,299
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities		
Current Liabilities		
Accrued compensation	$ 258,895	$ 374,025
Accounts payable and accrued expenses	389,758	400,761
Short-term borrowings	251,475	250,000
Current portion of long-term debt	7,515	8,188
Fund support	-	20,631

Other	156,987	227,588
Total current liabilities	1,064,630	1,281,193
Deferred compensation	134,193	105,115
Deferred income taxes	262,756	258,944
Other	268,175	225,400
Long-term debt	1,698,821	2,732,002
Total Liabilities	3,428,575	4,602,654
Commitments and Contingencies		
Redeemable Noncontrolling Interests	37,910	31,020
Stockholders Equity		
Common stock, par value $.10; authorized 500,000,000 shares; issued 161,330,022 shares and 141,853,025 shares, respectively	16,133	14,185
Preferred stock, par value $10; authorized 4,000,000 shares;		
no shares outstanding	-	-
Shares exchangeable into common stock	2,830	3,069
Additional paid-in capital	4,431,337	3,452,530
Employee stock trust	(33,384)	(35,094)
Deferred compensation employee stock trust	33,384	35,094
Retained earnings	1,218,845	1,131,625
Accumulated other comprehensive income (loss), net	61,022	(2,784)
Total Stockholders Equity	5,730,167	4,598,625
Total Liabilities and Stockholders Equity	$ 9,196,652	$ 9,232,299

See Notes to Consolidated Financial Statements

LEGG MASON, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2009	2008	2009	2008
Operating Revenues				
Investment advisory fees				
Separate accounts	$ 206,972	$ 283,116	$ 397,860	$ 599,791
Funds	347,371	540,829	675,395	1,110,387
Performance fees	9,566	3,437	15,250	13,582
Distribution and service fees	94,619	135,796	181,320	289,295
Other	1,368	2,959	3,155	7,113
Total operating revenues	659,896	966,137	1,272,980	2,020,168
Operating Expenses				
Compensation and benefits	287,559	322,183	556,371	699,851
Distribution and servicing	174,388	278,969	346,852	586,842
Communications and technology	40,538	49,085	81,028	99,371
Occupancy	35,689	33,755	68,273	67,899
Amortization of intangible assets	5,664	9,599	11,292	19,223
Other	38,174	52,333	72,965	97,822
Total operating expenses	582,012	745,924	1,136,781	1,571,008
Operating Income	77,884	220,213	136,199	449,160
Other Non-Operating Income (Expense)				
Interest income	1,737	21,025	3,558	44,293
Interest expense	(28,565)	(45,832)	(71,955)	(90,295)
Fund support	5,613	(324,640)	23,171	(591,514)
Other income (expense)	18,324	(38,646)	64,724	(37,339)
Total other non-operating income (expense)	(2,891)	(388,093)	19,498	(674,855)
Income (Loss) before Income Tax Provision (Benefit)	74,993	(167,880)	155,697	(225,695)
Income tax provision (benefit)	27,671	(58,891)	56,051	(80,625)
Net Income (Loss)	47,322	(108,989)	99,646	(145,070)
Less: Net income (loss) attributable to noncontrolling interests	1,548	(254)	3,818	(208)
Net Income (Loss) Attributable to	$ 45,774	$ (108,735)	$ 95,828	$ (144,862)

Legg Mason, Inc.

LEGG MASON, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(continued)

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2009	2008	2009	2008
Net Income (Loss) per Share Attributable to Legg Mason, Inc. Common Shareholders:				
Basic	$ 0.30	$ (0.77)	$ 0.65	$ (1.03)
Diluted	$ 0.30	$ (0.77)	$ 0.64	$ (1.03)
Weighted Average Number of Shares Outstanding:				
Basic	151,267	140,900	146,696	140,573
Diluted	153,224	140,900	148,708	140,573
Dividends Declared per Share	$ 0.03	$ 0.24	$ 0.06	$ 0.48

See Notes to Consolidated Financial Statements

LEGG MASON, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Dollars in thousands)

(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2009	2008	2009	2008
Net Income (Loss)	$ 47,322	$ (108,989)	$ 99,646	$ (145,070)
Other comprehensive income gains (losses):				
Foreign currency translation adjustment	22,469	(46,247)	63,804	(33,709)
Unrealized gains (losses) on investment securities:				
Unrealized holding gains (losses), net of tax provision (benefit) of $18, $6, $2 and $(19), respectively	27	10	3	(36)
Reclassification adjustment for realized (gains) losses included in net income (loss)	(1)	1	(1)	1
Net unrealized gains (losses) on investment securities	26	11	2	(35)
Unrealized and realized gains on cash flow hedge, net of tax provision of $201 and $569, respectively	-	324	-	783
Total other comprehensive income (loss)	22,495	(45,912)	63,806	(32,961)
Comprehensive Income (Loss)	69,817	(154,901)	163,452	(178,031)
Less: Comprehensive income (loss) attributable to noncontrolling interests	1,548	(254)	3,818	(208)
Comprehensive Income (Loss) Attributable to Legg Mason, Inc.	$ 68,269	$ (154,647)	$ 159,634	$ (177,823)

See Notes to Consolidated Financial Statements

LEGG MASON, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF

CHANGES IN STOCKHOLDERS EQUITY

(Dollars in thousands)

(Unaudited)

	Six Months Ended September 30, 2009	Six Months Ended September 30, 2008
COMMON STOCK		
Beginning balance	$ 14,185	$ 13,856
Stock options and other stock-based compensation	9	47
Deferred compensation employee stock trust	10	11
Deferred compensation, net	60	44
Exchangeable shares	9	65
Equity Units exchanged	1,860	
Preferred share conversions		37
Ending balance	16,133	14,060
SHARES EXCHANGEABLE INTO COMMON STOCK		
Beginning balance	3,069	4,982
Exchanges	(239)	(1,634)
Ending balance	2,830	3,348
ADDITIONAL PAID-IN CAPITAL		
Beginning balance, as reported	3,284,347	3,278,376
Recognition of conversion value of 2.5% senior notes, net of tax, pursuant to new accounting requirement	168,183	168,183
Beginning balance, as adjusted	3,452,530	3,446,559
Stock options and other stock-based compensation	10,527	23,802
Deferred compensation employee stock trust	2,325	3,382
Deferred compensation, net	14,831	15,582
Exchangeable shares	230	1,569
Equity Units exchanged (issued)	950,894	(73,430)
Preferred share conversions		(37)
Ending balance	4,431,337	3,417,427
EMPLOYEE STOCK TRUST		
Beginning balance	(35,094)	(29,307)
Shares issued to plans	(2,158)	(2,926)

Distributions and forfeitures	3,868	
Ending balance	(33,384)	(32,233)
DEFERRED COMPENSATION EMPLOYEE STOCK TRUST		
Beginning balance	35,094	29,307
Shares issued to plans	2,158	2,926
Distributions and forfeitures	(3,868)	
Ending balance	33,384	32,233
RETAINED EARNINGS		
Beginning balance, as reported	1,155,660	3,240,359
Recognition of conversion value of 2.5% senior notes, net of tax, pursuant to new accounting requirement	(24,035)	(4,045)
Beginning balance, as adjusted	1,131,625	3,236,314
Net income (loss) attributable to Legg Mason, Inc.	95,828	(144,862)
Dividends declared	(8,608)	(68,125)
Ending balance	1,218,845	3,023,327
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS), NET		
Beginning balance	(2,784)	82,930
Unrealized holding gains (losses) on investment securities, net of tax	2	(35)
Unrealized and realized gains on cash flow hedge, net of tax		783
Foreign currency translation adjustment	63,804	(33,709)
Ending balance	61,022	49,969
TOTAL STOCKHOLDERS EQUITY	$ 5,730,167	$ 6,508,131

See Notes to Consolidated Financial Statements

LEGG MASON, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Six Months Ended September 30, 2009	2008
Cash Flows from Operating Activities		
Net income (loss)	$ 99,646	$ (145,070)
Loss on Equity Unit exchange	22,040	-
Non-cash items included in net income (loss):		
Depreciation and amortization	55,013	66,843
Imputed interest for 2.5% convertible senior notes	16,951	15,915
Amortization of deferred sales commissions	13,217	18,420
Accretion and amortization of securities discounts and premiums, net	5,680	3,358
Stock-based compensation	23,232	26,260
Unrealized losses (gains) on investments	(84,051)	47,181
Unrealized losses (gains) on fund support	(22,115)	591,514
Deferred income taxes	16,558	(116,579)
Other	1,127	5,233
Decrease (increase) in assets excluding acquisitions:		
Investment advisory and related fees receivable	(36,235)	63,999
Net sales (purchases) of trading investments	40,761	(311,731)
Refundable income taxes	574,195	(60,907)
Other receivables	88,870	3,951
Other assets	102,304	15,373
Increase (decrease) in liabilities excluding acquisitions:		
Accrued compensation	(119,011)	(234,782)
Deferred compensation	29,078	(12,739)
Accounts payable and accrued expenses	(11,003)	(25,840)
Other liabilities	(158,791)	(14,746)
Cash Provided by (Used for) Operating Activities	657,466	(64,347)
Cash Flows from Investing Activities		
Payments for fixed assets	(58,052)	(57,752)
Payments for business acquisition-related costs	(7,524)	-
Proceeds from sale of assets	-	181,147

Fund Support:		
Restricted cash, net (principally fund support collateral)	18,789	(379,753)
Payments under liquidity fund support arrangements	-	(10,473)
Proceeds from sale of SIV securities	-	87,372
Purchases of SIV securities, net of distributions	-	(608,924)
Net increase in securities purchased under agreements to resell	-	604,642
Purchases of investment securities	(591)	(832)
Proceeds from sales and maturities of investment securities	830	1,598
Cash Used for Investing Activities	(46,548)	(182,975)

LEGG MASON, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(continued)

(Dollars in thousands)

(Unaudited)

	Six Months Ended September 30,	
	2009	2008
Cash Flows from Financing Activities		
Net increase in short term borrowings	1,475	-
Proceeds from issuance of long-term debt, net	-	1,095,465
Third-party distribution financing, net	(1,415)	(1,826)
Repayment of principal on long-term debt	(2,430)	(427,174)
Payment on Equity Unit exchange	(132,450)	-
Issuance of common stock	4,455	16,931
Dividends paid	(38,596)	(67,701)
Net subscriptions received from/(redemptions/distributions paid to) noncontrolling interest holders	3,072	7,452
Excess tax benefit associated with stock-based compensation	-	2,031
Cash (Used for) Provided by Financing Activities	(165,889)	625,178
Effect of Exchange Rate Changes on Cash	18,604	(4,888)
Net Increase in Cash and Cash Equivalents	463,633	372,968
Cash and Cash Equivalents at Beginning of Period	1,084,474	1,463,554
Cash and Cash Equivalents at End of Period	$ 1,548,107	$ 1,836,522

See Notes to Consolidated Financial Statements

LEGG MASON, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts, unless otherwise noted)

September 30, 2009

(Unaudited)

1. Interim Basis of Reporting

The accompanying unaudited interim consolidated financial statements of Legg Mason, Inc. and its subsidiaries (collectively Legg Mason) have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information. The interim consolidated financial statements have been prepared using the interim basis of reporting and, as such, reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair statement of the results for the periods presented. Legg Mason has evaluated all subsequent events through the time that we filed these financial statements in our quarterly report on Form 10-Q Report with the Securities and Exchange Commission on November 6, 2009.

The nature of our business is such that the results of any interim period are not necessarily indicative of the results of a full year. The fiscal year-end condensed balance sheet was derived from audited financial statements and, in accordance with interim financial information standards, does not include all disclosures required by U.S. GAAP for annual financial statements. Certain amounts in prior period financial statements have been reclassified to conform to the current period presentation, including fund support previously reported as Other income (expense) and Net purchases of trading investments.

The information contained in the interim consolidated financial statements should be read in conjunction with our latest Annual Report on Form 10-K filed with the Securities and Exchange Commission.

Unless otherwise noted, all per share amounts include both common shares of Legg Mason and shares issued in connection with the acquisition of Legg Mason Canada Inc., which are exchangeable into common shares of Legg Mason on a one-for-one basis at any time. The preparation of interim consolidated financial statements requires management to make assumptions and estimates that affect the amounts reported in the interim consolidated financial statements and accompanying notes. Actual amounts could differ from those estimates and the differences could have a material impact on the interim consolidated financial statements.

Terms such as we, us, our, and company refer to Legg Mason.

2. Significant Accounting Policies

Retrospective Accounting Policies Adopted

Certain prior year amounts have been retrospectively revised as a result of the adoption of new accounting guidance relating to the financial statement presentation of noncontrolling interests and debt with conversion and other options.

New accounting guidance relating to the financial statement presentation of noncontrolling interests has both retrospective and prospective provisions and under the retrospective provisions, minority interests have been recharacterized as noncontrolling interests and classified as a component of equity, if permanent. Also, net income (loss) is no longer affected by minority interests, but under the new guidance, both net income (loss) and comprehensive income (loss) are attributed to noncontrolling and parent interests. Further, the guidance requires temporary equity classification for instruments that are currently redeemable or convertible for cash or other assets at the option of the holder. For Legg Mason, minority interests of $31,020 related to consolidated sponsored investment funds that are redeemable for cash or other assets have been recharacterized and classified as Redeemable noncontrolling interests on the Consolidated Balance Sheets as of March 31, 2009. During the three and six months ended September 30, 2009, net income attributable to noncontrolling interests was $1,548 and $3,818, respectively. Redeemable noncontrolling interests as of September 30, 2009 and 2008, were $37,910 and $7,336, with changes during the six months then ended as follows:

	Six Months Ended September 30,	
	2009	2008
Balance, beginning of period	$ 31,020	$ 92
Net income (loss) attributable to noncontrolling interests	3,818	(208)
Net subscriptions received from/ (redemptions/distributions paid to) noncontrolling interest holders	3,072	7,452
Balance, end of period	$ 37,910	$ 7,336

The prospective provisions of the new guidance do not have a material impact on Legg Mason s consolidated financial statements.

New accounting guidance relating to debt with conversion and other options requires that issuers of convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) should separately account for the liability and equity (conversion feature) components of the instruments. As a result, interest expense should be imputed and recognized based upon the entity s nonconvertible debt borrowing rate at the date of issuance, which results in lower net income. The 2.5% convertible senior notes issued by Legg Mason in January 2008 are subject to the new guidance. Prior to the new guidance, no portion of the proceeds from the issuance of the instrument was attributable to the conversion feature. Upon retrospective application of the new guidance, the effects on Net loss and Net loss per share for the three and six months ended September 30, 2008, and on Long-term debt, Retained earnings, Additional paid-in capital and Deferred income tax assets as of March 31, 2009 were as follows:

	Three Months Ended	Six Months Ended
	September 30, 2008	
Net loss, as previously reported	$ (103,751)	$ (135,024)
Additional interest expense pursuant to the new accounting requirement, net of income taxes	(4,984)	(9,838)
Net loss attributable to Legg Mason, Inc., as currently reported	$ (108,735)	$ (144,862)
Net loss per share attributable to Legg Mason, Inc. common shareholders:		
Basic, as previously reported	$ (0.74)	$ (0.96)
Additional interest expense pursuant to the new accounting requirement, net of income taxes	(0.03)	(0.07)
Basic, as currently reported	$ (0.77)	$ (1.03)
Diluted, as previously reported	$ (0.74)	$ (0.96)
Additional interest expense pursuant to the new accounting requirement, net of income taxes	(0.03)	(0.07)
Diluted, as currently reported	$ (0.77)	$ (1.03)

	March 31, 2009
Long-term debt, as previously reported	$ 2,965,204
Impact of the new accounting requirement	(233,202)
Long-term debt, as currently reported	$ 2,732,002
Retained earnings, as previously reported	$ 1,155,660
Impact of the new accounting requirement	(24,035)
Retained earnings, as currently reported	$ 1,131,625
Additional paid-in capital, as previously reported	$ 3,284,347
Impact of the new accounting requirement	168,183
Additional paid-in capital, as currently reported	$ 3,452,530
Deferred income tax assets, as previously reported	$ 848,488
Impact of the new accounting requirement	(89,055)

Deferred income tax assets, as currently reported	$	759,433

Additional disclosures required under the new accounting requirement are addressed in Note 6.

Fair Value Measurements

Accounting guidance for fair value measurement and disclosures 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. 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 nonperformance.

The fair value accounting guidance 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.

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 fund support arrangements, 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 structured investment vehicles (SIVs). This category may also include certain proprietary fund products with redemption restrictions.

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.

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

See Note 3 for additional information regarding fair value measurements.

Recent Accounting Developments

The following relevant accounting pronouncements were recently issued.

In June 2009, the FASB issued amendments relating to the consolidation of variable interest entities, which will be effective for Legg Mason in fiscal 2011. The amendments include a new approach for determining who should consolidate a variable interest entity (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 new approach for determining who should consolidate a VIE requires an analysis of whether a variable interest gives an enterprise a controlling financial interest in a VIE through both the power to direct the activities that most significantly impact the VIE s economic performance and the obligation to absorb losses or the right to benefits that could potentially be significant to the VIE. The amendments replace the quantitative approach previously required to determine whether a VIE should be consolidated with a qualitative analysis. The amendments also require that for kick-out rights to be effective, they must be vested with one party, rather than a simple majority of parties, as under prior guidance. Legg Mason is continuing to evaluate the impact of the amendments and currently expects that they may require the consolidation of certain sponsored funds, particularly those with performance

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fees, high related party ownership, or implicit variable interests, such as fund support, that will be material to its balance sheet, revenues and expenses, but have no impact on net income attributable to Legg Mason, Inc.

In September 2009, the FASB issued amendments relating to fair value measurements and disclosures of investments in certain entities that calculate net assets per share. The new guidance permits, as a practical expedient, a reporting entity to measure the fair value of qualifying investments that do not have a readily determinable fair value, such as private equity funds and partnership investments, at net asset value per share as of the reporting date without consideration of certain attributes of the investment, such as restrictions on redemptions. The amendments also require disclosures by major category of investment about various attributes of these investments. Legg Mason will adopt these amendments for the reporting period ending December 31, 2009, and does not expect the adoption to materially impact its financial position or results of operations.

3. Fair Values of Assets and Liabilities

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

	Value as of September 30, 2009			
	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
ASSETS:				
Investments relating to long-term incentive compensation plans[1]	$ 176,625	$ -	$ -	$ 176,625
Proprietary fund products and other investments[2]	88,022	64,650	57,300	209,972
Total trading investment securities	264,647	64,650	57,300	386,597
Available-for-sale investment securities	2,600	3,917	12	6,529
Investment in partnerships and LLCs	1,117	-	74,668	75,785
Derivative assets:				
Currency hedges	2,822	-	-	2,822
Equity securities	-	-	2,061	2,061
	$ 271,186	$ 68,567	$ 134,041	$ 473,794
LIABILITIES:				
Derivative liabilities:				
Currency hedges	$ (1,604)	$ -	$ -	$ (1,604)

	Value as of March 31, 2009			
	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
ASSETS:				
Investments relating to long-term incentive compensation plans[1]	$ 128,785	$	$	$ 128,785
Proprietary fund products and other investments[2]	115,117	51,471	40,719	207,307
Total trading investment securities	243,902	51,471	40,719	336,092
Available-for-sale investment securities	3,105	3,701	12	6,818
Investment in partnerships and LLCs	796		58,719	59,515
Derivative assets:				
Currency hedges	8,976			8,976
Equity securities			2,340	2,340
	$ 256,779	$ 55,172	$ 101,790	$ 413,741
LIABILITIES:				
Derivative liabilities:				
Fund support	$	$	$ (20,631)	$ (20,631)
Currency hedges	(773)			(773)
	$ (773)	$	$ (20,631)	$ (21,404)

(1)

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 deferred compensation liability.

(2)

Primarily mutual funds that are invested approximately 67% and 33% in equity and debt securities as of September 30, 2009, respectively, and were approximately equally invested in equity and debt securities as of March 31, 2009. Includes approximately $22.5 million and $16.6 million related to noncontrolling interests of consolidated investment funds as of September 30, 2009 and March 31, 2009, respectively.

The tables below present a summary of changes in financial assets and (liabilities) measured at fair value using significant unobservable inputs (Level 3) for the periods from April 1, 2009 to September 30, 2009 and April 1, 2008 to September 30, 2008:

	Value as of April 1, 2009	Purchases, sales, issuances and settlements, net	Net transfer in (out) of Level 3	Realized and unrealized gains/(losses), net	Value as of September 30, 2009
ASSETS:					
Proprietary fund products and other investments	$ 40,719	$ (694)	$ 10,414	$ 6,861	$ 57,300
Investment in partnerships and LLCs	58,719	14,921		1,028	74,668
Other investments	2,352	(530)		251	2,073
	$ 101,790	$ 13,697	$ 10,414	$ 8,140	$ 134,041
LIABILITIES:					
Fund support	$ (20,631)	$	$	$ 20,631	$
Total realized and unrealized gains, net				$ 28,771	

	Value as of April 1, 2008	Purchases, sales, issuances and settlements, net	Net transfer in (out) of Level 3	Realized and unrealized gains/(losses), net	Value as of September 30, 2008
ASSETS:					
Securities issued by SIVs	$ 141,509	$ 521,553	$	$ (208,171)	$ 454,891
Proprietary fund products and other investments	23,781	(13,781)	10,210	(7,071)	13,139
Investment in partnerships and LLCs	67,022	(9,953)		2,415	59,484
Total return swap	45,706	(9,527)		(19,890)	16,289
Other investments	1,903			(701)	1,202
	$ 279,921	$ 488,292	$ 10,210	$ (233,418)	545,005
LIABILITIES:					
Fund support	$ (551,654)	$	$	$ (364,345)	$ (915,999)
Total realized and unrealized (losses), net				$ (597,763)	

Realized and unrealized gains and losses recorded for Level 3 investments are included in Other income (expense) on the Consolidated Statements of Operations. The total net realized and unrealized gains (losses) of $28.8 million and $(597.8) million for the quarters ended September 30, 2009 and 2008, respectively, are attributable to the change in unrealized gains (losses) relating to the assets and liabilities still held at the reporting date.

4. 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 purchased software and internally developed software. Fixed assets are reported at cost, net of accumulated depreciation and amortization. The following table reflects the components of fixed assets as of:

	September 30, 2009	March 31, 2009
Equipment	$ 196,390	$ 180,668
Software	205,609	193,109
Leasehold improvements and capital lease assets	342,779	314,963
Total cost	744,778	688,740
Less: accumulated depreciation and amortization	(360,667)	(321,697)
Fixed assets, net	$ 384,111	$ 367,043

Depreciation and amortization expense included in operating income was $21,704 and $24,794 for the quarters ended September 30, 2009 and 2008, respectively, and $43,721 and $47,620 for the six months ended September 30, 2009 and 2008 respectively. The increase in cost of fixed assets primarily reflects expenditures for furniture and leasehold improvements associated with the move to our new corporate headquarters.

5. Intangible Assets and Goodwill

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

	September 30, 2009	March 31, 2009
Amortizable asset management contracts		
Cost	$ 212,522	$ 208,416
Accumulated amortization	(122,250)	(108,376)
Net	90,272	100,040
Indefinite life intangible assets		
Fund management contracts	3,753,632	3,752,961
Trade names	69,800	69,800

	3,823,432	3,822,761
Intangible assets, net	$ 3,913,704	$ 3,922,801

As of September 30, 2009, management contracts are being amortized over a weighted-average life of 4.7 years. Estimated amortization expense for each of the next five fiscal years is as follows:

Remaining 2010	$ 11,512
2011	22,900
2012	19,831
2013	14,661
2014	12,455
Thereafter	8,913
Total	$ 90,272

The increase in the carrying value of goodwill for the six months ended September 30, 2009 is summarized below:

Balance, beginning of period	$ 1,186,747
Contractual acquisition earnouts	80,000
Impact of excess tax basis amortization	(10,912)
Other, including changes in foreign exchange rates	45,177
Balance, end of period	$ 1,301,012

Based on the revenues and earnings of Permal Group Ltd. (Permal), during the six months ended September 30, 2009, Legg Mason increased its accrual for contingent consideration, related to a fourth anniversary payment under the purchase contract for the acquisition of Permal, by $80 million, to $161 million, with a corresponding increase in goodwill.

6. Debt and Equity Units

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

	September 30, 2009			March 31, 2009
	Current Accreted Value	Unamortized Discount	Maturity Amount	Current Accreted Value
5-year term loan	$ 550,000	$	$ 550,000	$ 550,000
2.5% convertible senior notes	1,033,749	216,251	1,250,000	1,016,798

5.6% senior notes from Equity Units	103,039		103,039	1,150,000
Third-party distribution financing	2,653		2,653	4,067
Other term loans	16,895		16,895	19,325
Subtotal	1,706,336	216,251	1,922,587	2,740,190
Less: current portion	7,515		7,515	8,188
Total	$ 1,698,821	$ 216,251	$ 1,915,072	$ 2,732,002

As of September 30, 2009, the aggregate maturities by fiscal year of long-term debt based on the contractual terms are as follows:

Remaining 2010	$ 5,136
2011	553,515
2012	2,329
2013	843
2014	894
Thereafter	1,359,870
Total	$ 1,922,587

At September 30, 2009, the estimated fair value of long-term debt was approximately $1,703,152.

Legg Mason is accreting the carrying value of the 2.5% convertible senior notes to the principal amount at maturity using an interest rate of 6.5% (the effective borrowing rate for non-convertible debt at the time of issuance) over its expected life of seven years, resulting in additional interest expense for the quarters ended September 30, 2009 and 2008 of approximately $8.6 million and $8.1 million, respectively. The amount by which the notes if-converted value exceeds the accreted value as of September 30, 2009 is approximately $38.5 million using a current interest rate of 5.54%, representing a potential loss.

During the September 2009 quarter, Legg Mason completed a tender offer and retired 91% of its outstanding Equity Units (20.9 million units) including the extinguishment of $1.05 billion of its outstanding 5.6% Senior notes and termination of the related purchase contracts in exchange for the issuance of 18.6 million shares of Legg Mason common stock and a payment of $130.9 million 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 $22.0 million (including a non-cash charge of $6.3 million of accelerated expense of deferred issue costs) and a decrease in additional paid-in capital of $115.2 million.

Legg Mason s $100 million, one-year revolving credit agreement for general operating purposes expired with no borrowings outstanding in September 2009.

7. Stock-Based Compensation

Compensation expense relating to stock options, the stock purchase plan and deferred compensation for the three months ended September 30, 2009 and 2008 was $3,480 and $4,270, respectively, and for the six months ended

September 30, 2009 and 2008 was $9,183 and $11,218, respectively.

Stock option transactions during the six months ended September 30, 2009 and 2008, respectively, are summarized below:

	Six months ended September 30,			
	2009		2008	
	Number of shares	Weighted-average exercise price per share	Number of shares	Weighted-average exercise price per share
Options outstanding at March 31	5,200	$ 65.19	5,464	$ 67.20
Granted	1,455	26.81	1,147	33.97
Exercised	(24)	26.31	(489)	32.05
Canceled/ forfeited	(729)	49.01	(236)	58.32
Options outstanding at September 30	5,902	$ 58.14	5,886	$ 64.00

At September 30, 2009, options were exercisable for 2,618 shares with a weighted-average exercise price of $75.61 and a weighted-average remaining contractual life of 3.7 years. Unamortized compensation cost related to unvested options (3,284 shares) at September 30, 2009 of $52,888 is expected to be recognized over a weighted-average period of 2.2 years.

The weighted average fair value of option grants of $12.09 and $14.23 per share for the six months ended September 30, 2009 and 2008, respectively, is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	Six months ended September 30,	
	2009	2008
Expected dividend yield	1.45%	0.86%
Risk-free interest rate	2.86%	3.38%
Expected volatility	55.27%	48.22%
Expected lives (in years)	5.17	4.81

Compensation expense relating to restricted stock for the three months ended September 30, 2009 and 2008 was $6,879 and $6,467, respectively, and for the six months ended September 30, 2009 and 2008 was $14,049 and

$15,042, respectively.

Restricted stock transactions during the six months ended September 30, 2009 and 2008, respectively, are summarized below:

	Six months ended September 30,			
	2009		2008	
	Number of shares	Weighted-average grant date value	Number of shares	Weighted-average grant date value
Unvested shares at March 31	1,324	$ 50.25	642	$ 98.30
Granted	626	21.50	459	53.00
Vested	(270)	59.34	(100)	105.57
Canceled/ forfeited	(51)	31.38	(26)	79.89
Unvested shares at September 30	1,629	$ 38.55	975	$ 77.09

Unamortized compensation cost related to unvested restricted stock awards at September 30, 2009 of $44,702 is expected to be recognized over a weighted-average period of 2.7 years.

Restricted stock unit transactions during the six months ended September 30, 2009 and 2008, respectively, are summarized below:

	Six months ended September 30,			
	2009		2008	
	Number of shares	Weighted-average grant date value	Number of shares	Weighted-average grant date value
Unvested shares at March 31	17	$ 37.23		
Granted	98	22.13	16	$ 61.85
Vested	(4)	23.11		
Canceled/ forfeited			(1)	61.85
Unvested shares at September 30	111	$ 24.53	15	$ 42.13

Unamortized compensation cost related to unvested restricted stock units at September 30, 2009 of $2,088 is expected to be recognized over a weighted-average period of 3.6 years.

During the quarter ended September 30, 2009, non-employee directors were issued 18 restricted stock units and 27 shares of common stock at a fair value of $1,250. As of September 30, 2009 there were 288 stock options and 38 restricted stock units outstanding. During the six months ended September 30, 2009, 27 stock options were exercised and 41 stock options were cancelled or forfeited.

8. Commitments and Contingencies

Legg Mason leases office facilities and equipment under non-cancelable operating leases and also has multi-year agreements for certain services. These leases and service agreements expire on varying dates through fiscal 2025. Certain leases provide for renewal options and contain

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escalation clauses providing for increased rentals based upon maintenance, utility and tax increases.

As of September 30, 2009, the minimum annual aggregate rentals under operating leases and servicing agreements are as follows:

Remaining 2010	$ 79,969
2011	130,582
2012	119,839
2013	106,778
2014	89,089
Thereafter	685,263
Total	$ 1,211,520

The minimum rental commitments shown above have not been reduced by $119,016 for minimum sublease rentals to be received in the future under non-cancelable subleases, of which approximately 76% is due from one counterparty. If a sub-tenant defaults on a sublease, Legg Mason may incur operating expense charges to reflect expected future sublease rentals at reduced amounts, as a result of the current commercial real estate market.

The table above also does not include aggregate obligations of $35,198 for property and equipment under capital leases, primarily related to a put/purchase option agreement with the owner of land and a building currently leased by Legg Mason.

As of September 30, 2009, Legg Mason had commitments to invest approximately $23,756 in investment vehicles. These commitments will be funded as required through the end of the respective investment periods through fiscal 2011.

See Note 10, Liquidity Fund Support, for additional information related to Legg Mason commitments.

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 is also involved in governmental and self-regulatory agency inquiries, investigations and proceedings.

In accordance with accounting guidance 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. While the ultimate resolution of these matters cannot be currently determined, in the opinion of management, after consultation with legal counsel, Legg Mason does not believe that the resolution of these actions will have a material adverse effect on Legg Mason s financial condition. However, the results of operations could be materially affected during any period if liabilities in that period differ from Legg Mason s prior estimates, and Legg Mason s cash flows could be materially affected during any period in which these matters are 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.

Legg Mason and a current and former officer, together with an underwriter in a public offering, were named as defendants in a consolidated legal action. The action alleged that the defendants violated the Securities Act of 1933 by omitting certain material facts with respect to the acquisition of Citigroup s worldwide asset management business in a prospectus used in a secondary stock offering in order to artificially inflate the price of Legg Mason common stock. The action sought certification of a class of shareholders who purchased Legg Mason common stock in a secondary public offering on or about March 9, 2006 and sought unspecified damages. Legg Mason intends to defend the action vigorously. On March 17, 2008, the action was dismissed with prejudice. The plaintiffs appealed the dismissal, and on September 30, 2009, the dismissal was affirmed by the U.S. Court of Appeals for the Second Circuit. The plaintiffs only procedural alternative at this time is to request the U.S. Supreme Court to permit the plaintiffs to appeal the Second Circuit s judgment. Legg Mason cannot predict whether any possible future action on this case will have a material adverse effect on the Company.

9. Earnings Per Share

Basic earnings per share attributable to Legg Mason, Inc. common shareholders (EPS) 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 and shares exchangeable into common stock. Diluted EPS is similar to basic EPS, but adjusts for the effect of potentially issuable common shares, except when inclusion is antidilutive.

For periods where a net loss attributable to Legg Mason, Inc. is reported, the inclusion of potentially issuable common shares will decrease the net loss per share. Since this would be antidilutive, such shares are excluded from the calculation. Basic and diluted earnings per share for the three and six months ended September 30, 2009 and 2008 include all vested shares of restricted stock related to Legg Mason s deferred compensation plans. Legg Mason issued 18,600 shares of common stock through the Equity Units tender offer and 9,096 and 4,573 shares are included in weighted average shares outstanding for the three and six months ended September 30, 2009, respectively.

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

	Three Months Ended September 30,			
	2009		2008	
	Basic	Diluted	Basic	Diluted (1)
Weighted average shares outstanding	151,267	151,267	140,900	140,900
Potential common shares:				
Employee stock options	-	83	-	-
Unvested shares related to deferred compensation	-	422	-	-
Shares issuable upon payment of contingent consideration	-	1,452	-	-
Total weighted average diluted shares	151,267	153,224	140,900	140,900
Net income (loss) attributable to Legg Mason, Inc.	$ 45,774	$ 45,774	$ (108,735)	$ (108,735)
Net income (loss) per share attributable to Legg Mason, Inc. common shareholders	$ 0.30	$ 0.30	$ (0.77)	$ (0.77)

	Six Months Ended September 30,			
	2009		2008	
	Basic	Diluted	Basic	Diluted (1)
Weighted average shares outstanding	146,696	146,696	140,573	140,573
Potential common shares:				
Employee stock options	-	25	-	-
Unvested shares related to deferred compensation	-	325	-	-
Shares issuable upon payment of contingent consideration	-	1,662	-	-
Total weighted average diluted shares	146,696	148,708	140,573	140,573
Net income (loss) attributable to Legg Mason, Inc.	$ 95,828	$ 95,828	$ (144,862)	$ (144,862)
Net income (loss) per share attributable to Legg Mason, Inc. common shareholders	$ 0.65	$ 0.64	$ (1.03)	$ (1.03)

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

The diluted EPS calculation for the three and six month periods ended September 30, 2008 excludes 5,425 and 5,270 potential common shares, respectively, that are antidilutive due to the net loss for the periods. Also, the diluted EPS calculations for the three and six months ended September 30, 2009 and 2008 exclude any potential common shares issuable under the convertible 2.5% senior notes or the remaining 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.

In addition, during the current quarter, based on the revenues and earnings of Permal, Legg Mason increased its accrual for contingent consideration by $80 million, to $161 million, with a corresponding increase in goodwill. Under the acquisition agreement, Legg Mason can settle up to 25% of this contingency with the issuance of its common shares and these potential shares are included in the shares issuable upon payment of contingent consideration.

Options to purchase 5,153 shares for the three months ended September 30, 2009 and 5,658 shares for the six months ended September 30, 2009, respectively, were not included in the computation of diluted earnings per share because the presumed proceeds from exercising such options exceed the average price of the common shares for the period and therefore the options are deemed antidilutive. Diluted earnings per share for the three and six months ended September 30, 2009 period also include unvested shares of restricted stock related to those plans, except for 1,221 and 1,319 shares, respectively, which were deemed antidilutive.

10. Liquidity Fund Support

The par value, support amounts, collateral and income statement impact for the three and six months ended September 30, 2009 and 2008, for all support provided to certain liquidity funds that remained outstanding as of the end of each period were as follows:

				As of September 30, 2009			
				Three Months		Six Months	
Description	Par Value	Support Amount	Cash Collateral[1]	Pre Tax Gain[2]	After Tax Gain[3]	Pre Tax Gain[2]	After Tax Gain[3]
Capital Support Agreements Non-asset Backed Securities	n/m	$ 5,000	$ 5,000	$ (5,613)	$ (4,041)	$ (23,171)	$ (16,565)

				As of September 30, 2008			
				Three Months		Six Months	
Description	Par Value	Support Amount	Cash Collateral[1]	Pre Tax Charge[2]	After Tax Charge[3]	Pre Tax Charge[2]	After Tax Charge[3]
Letters of Credit	$ 437,000	$ 150,000	$	$ 18,168	$ 10,695	$ 40,223	$ 22,610
Capital Support Agreements Asset Backed Securities	2,311,000	1,025,000	1,025,000	226,008	133,044	436,807	258,160
Capital Support Agreements Non-asset Backed Securities	n/m	20,000	20,000	13,729	8,084	13,729	8,084
Total Return Swap	640,000	640,000	174,030	14,804	8,715	19,890	11,462
Purchase of Non-bank	613,000	596,000		51,789	30,488	80,333	45,945

Sponsored SIVs[4]							
Purchase of Canadian Conduit Securities	91,000	91,000		142	83	532	294
Total		$ 2,522,000	$1,219,030	$ 324,640	$ 191,109	$ 591,514	$ 346,555

1 Included in restricted cash on the Consolidated Balance Sheet.

2 Pre tax (gains) charges include (increases) reductions in the value of underlying securities, in addition to gains (losses), primarily related to foreign exchange forward contracts and interest payments received, of $2,540 and $(911) for the six months ended September 30, 2009 and 2008. These items are included in Other income (expense) on the Consolidated Statements of Operations.

3 After tax and after giving effect to related operating expense adjustments, if applicable.

4 Securities issued by SIVs.

In April 2009, due to the stabilization of the net asset value of one of the supported liquidity funds, Legg Mason terminated one capital support agreement (CSA) to provide up to $7 million in contributions to the fund.

In July 2009, Legg Mason terminated another CSA to provide up to $7 million in contributions to one fund.

In September 2009, a CSA to provide up to $5 million in contributions to a fund expired in accordance with its terms and no amounts were drawn thereunder.

Also in September 2009, a CSA to provide up to $22.5 million in contributions to a fund was amended to reduce the maximum contribution that the Company would make to the fund thereunder to $5 million and extend the expiration of the CSA until March 2010.

11. Variable Interest Entities

In the normal course of its business, Legg Mason sponsors and is the manager of various types of investment vehicles that are considered VIEs. 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 except for cash payments under fund support agreements. 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 September 30, 2009 and March 31, 2009. Legg Mason has not issued any investment performance guarantees to these VIEs or their investors.

During fiscal 2010 and 2009, Legg Mason had variable interests in certain liquidity funds to which it has provided various forms of credit and capital support. After evaluating both the contractual and implied variable interests in these funds, as of September 30, 2009 and March 31, 2009, it has been determined that Legg Mason is not the primary beneficiary of these funds.

As of September 30, 2009 and March 31, 2009, Legg Mason was the primary beneficiary of one sponsored investment fund VIE, due to the level of corporate ownership, which resulted in consolidation. This VIE had total assets and total equity of $61.8 million and $48.2 million as of September 30, 2009 and March 31, 2009, respectively. Legg Mason s investment in this VIE was $32.3 million and $26.3 million as of September 30, 2009 and March 31, 2009, respectively, which represents the maximum risk of loss. The assets of this VIE are primarily comprised of investment securities.

As of September 30, 2009 and March 31, 2009, 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 VIEs assets and liabilities and maximum risk of loss were as follows:

As of September 30, 2009

	VIE Assets That the Company Does Not Consolidate	VIE Liabilities That the Company Does Not Consolidate	Equity Interests on the Consolidated Balance Sheet	Maximum Risk of Loss*
Liquidity funds subject to capital support	$ 1,008,135	$ 915	$	$ 5,000
CDOs/CLOs	3,909,553	3,601,583		938
Other sponsored investment funds	17,681,585	2,408	46,454	65,446
Total	$ 22,599,273	$ 3,604,906	$ 46,454	$ 71,384

	As of March 31, 2009			
	VIE Assets That the Company Does Not Consolidate	VIE Liabilities That the Company Does Not Consolidate	Equity Interests on the Consolidated Balance Sheet	Maximum Risk of Loss*
Liquidity funds subject to capital support	$ 7,548,539	$ 121,338	$	$ 41,500
CDOs/CLOs	5,116,004	4,786,604		1,566
Other sponsored investment funds	18,241,540	3,381	34,458	52,019
Total	$ 30,906,083	$ 4,911,323	$ 34,458	$ 95,085

*

Includes capital support to liquidity funds, equity interests the Company has made or is required to make and any earned but uncollected management fees.

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.

12. Derivatives and Hedging

During the three and six months ended September 30, 2009, Legg Mason did not hold any derivatives designated in a formal hedge relationship under accounting guidance for derivative and hedging activities.

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, and Australian dollar. As of September 30, 2009, Legg Mason had open currency forward contracts with aggregate gross fair values of $3,076 and $1,858, classified as Other assets and Other liabilities, respectively. 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. For the quarter and six months ended September 30, 2009, Legg Mason recognized losses of $4,195 and $7,753 included in Other expense relating to currency forward contracts intended to offset actual movements in currency exchange rates.

As more fully described in Note 10, Legg Mason has engaged in various forms of liquidity fund support transactions that constitute derivatives.

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

Legg Mason, Inc., a holding company, with its subsidiaries (which collectively comprise Legg Mason) is a global asset management firm. Acting through our subsidiaries, we provide investment management and related services to institutional and individual clients, company-sponsored mutual funds and other investment vehicles. We offer these products and services directly and through various financial intermediaries. We have operations principally in the United States of America 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 operate in one reportable business segment, Asset Management, with two divisions or operating segments: Americas and International, which are primarily based on the geographic location of the advisor or the domicile of the fund families we manage. The Americas Division consists of our U.S.-domiciled fund families, the separate account business of our U.S.-based investment affiliates and the U.S. distribution organization. Similarly, the International Division consists of our fund complexes, distribution teams and investment affiliates located outside the U.S.

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, among other things, the amount and composition of our assets under management, and the volatility and general level of securities prices and interest rates. 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. For a further discussion of factors that may affect our results of operations, refer to Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended March 31, 2009.

Certain prior year amounts have been retrospectively revised as a result of the adoption of new accounting guidance relating to financial statement presentation of noncontrolling interests and debt with conversion and other options. See Note 2 of Notes to Consolidated Financial Statements for more information on the adoption of new accounting guidance.

Terms such as we, us, our, and company refer to Legg Mason.

Business Environment

The financial environment in the United States continued to show further signs of improvement during the quarter ended September 30, 2009. During the quarter, equity markets rose as a result of slowing growth in unemployment rates, although still at elevated levels, stabilization of the financial sector, and improved consumer confidence and earnings across most industries. As a result, all three major U.S. equity market indices increased sharply during the quarter ended September 30, 2009. In the three months ended September 30, 2009, the NASDAQ Composite Index[1] increased 16%, and the S&P 500[2] and Dow Jones Industrial Average[3] each increased 15%. In the six months ended September 30, 2009, the NASDAQ Composite Index, S&P 500, and Dow Jones Industrial Average increased 39%, 32%, and 28%, respectively. The Barclays Capital Global Aggregate Bond Index[4] and the Barclays Capital U.S. Aggregate Bond Index[4] also increased 6% and 4%, respectively, during the quarter ended September 30, 2009 and increased 11% and 6%, respectively, during the six months ended September 30, 2009. During the quarter, the Federal Funds rate remained at 0.25%. However, despite recent improvements, the financial environment in which we operate continues to be challenging, and we expect the challenges presented by high unemployment and troubles in the real estate and credit markets to persist throughout the rest of the fiscal year. We cannot predict how these uncertainties will impact the Company s results.

Quarter Ended September 30, 2009 Compared to Quarter Ended September 30, 2008

Assets Under Management

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

	2009	2008
Beginning of period	$ 656.9	$ 922.8
Investment funds, excluding liquidity funds		
Sales	9.7	15.4
Redemptions	(8.8)	(21.0)
Separate account flows, net	(11.4)	(17.5)
Liquidity fund flows, net	2.4	3.1
Net client cash flows	(8.1)	(20.0)
Market performance and other (1)	53.9	(60.9)
End of period	$ 702.7	$ 841.9

(1)

Includes impact of foreign exchange

In the last three months, AUM increased by $45.8 billion or 7.0% from $656.9 billion at June 30, 2009 to $702.7 billion at September 30, 2009. The increase in AUM was attributable to market appreciation of $54 billion, of which approximately 9% resulted from the impact of foreign currency exchange fluctuation, which was partially offset by net client outflows of $8 billion. Net client outflows improved 73% compared to the quarter ended June 30, 2009 and improvements were seen in all asset classes. The majority of outflows were from fixed income with $10 billion, or

80% of the outflows, followed by equity outflows of $2 billion. Liquidity

[1] NASDAQ is a trademark of the NASDAQ Stock Market, Inc., which is not affiliated with Legg Mason.

[2] S&P is a trademark of Standard & Poor s, a division of the McGraw-Hill Companies, Inc., which is not affiliated with Legg Mason.

[3] Dow Jones Industrial Average is a trademark of Dow Jones & Company, which is not affiliated with Legg Mason.

[4] Barclays Capital U.S. Aggregate Bond Index and Barclays Capital Global Aggregate Bond Index are trademarks of Barclays Capital, which is not affiliated with Legg Mason.

inflows were $4 billion. The majority of fixed income outflows were in products managed by Western Asset Management Company (Western Asset). Equity outflows were primarily experienced at ClearBridge Advisors LLC (ClearBridge) and Batterymarch Financial Management, Inc. (Batterymarch). However, equity and fixed income outflows continue to decline and were significantly reduced compared to last quarter, 61% and 57%, respectively. As of September 30, 2009, our alternative investments are now classified as investment funds for reporting purposes. Prior period amounts have been reclassified to conform to the current period presentation.

For the quarter ended September 30, 2009, Permal experienced gross redemptions of approximately $1.2 billion, of which $1.0 billion were anticipated at the end of the June 2009 quarter due to their requirement for 95 days prior written notice of redemptions. These redemptions were substantially offset by $1.0 billion of subscriptions during the current quarter. During the quarter, Permal reduced, from 95 days to 35 days, the requirement for prior written notice of redemptions. It is expected that by January 2010 Permal will return to a redemption notice period of 20 days.

AUM at September 30, 2009 were $702.7 billion, a decrease of $139.2 billion or 16.5% from September 30, 2008. The decrease in AUM was attributable to net client outflows of $159 billion, partially offset by market appreciation of $20 billion, of which approximately 42% resulted from the impact of foreign currency exchange fluctuation. There were net client outflows in all asset classes. The majority of outflows were in fixed income with $98 billion, or 62% of the outflows, followed by equity outflows and liquidity outflows of $35 billion and $26 billion, respectively. The majority of fixed income outflows were in products managed by Western Asset that had experienced investment underperformance. Equity outflows were primarily experienced by products managed at ClearBridge, LMCM and Permal. Due in part to investment underperformance, we have experienced net equity outflows since fiscal 2007. 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. In addition, we have experienced outflows in our fixed income asset class for the past several quarters. While net outflows in the equity and fixed income areas have continued we have experienced improved net flows in all asset classes over the last four quarters.

AUM by Asset Class

AUM by asset class (in billions) as of September 30 was as follows:

	2009	% of Total	2008	% of Total	% Change
Equity	$ 165.6	23.6 %	$ 214.8	25.5 %	(22.9) %
Fixed Income	385.7	54.9	451.8	53.7	(14.6)
Liquidity	151.4	21.5	175.3	20.8	(13.6)
Total	$ 702.7	100.0 %	$ 841.9	100.0 %	(16.5) %

The component changes in our AUM by asset class (in billions) for the three months ended September 30, 2009 were as follows:

	Equity	Fixed Income	Liquidity	Total
June 30, 2009	$ 143.6	$ 366.6	$ 146.7	$ 656.9
Investment funds, excluding liquidity funds				
Sales	4.8	4.9		9.7
Redemptions	(5.5)	(3.3)		(8.8)
Separate account flows, net	(1.8)	(11.3)	1.7	(11.4)
Liquidity fund flows, net			2.4	2.4
Net client cash flows	(2.5)	(9.7)	4.1	(8.1)
Market performance	24.5	28.8	0.6	53.9
September 30, 2009	$ 165.6	$ 385.7	$ 151.4	$ 702.7

Average AUM by asset class (in billions) for the three months ended September 30 was as follows:

	2009	% of Total	2008	% of Total	% Change
Equity	$ 155.7	22.8 %	$ 239.9	26.7 %	(35.1) %
Fixed Income	377.5	55.2	476.7	53.1	(20.8)
Liquidity	150.8	22.0	181.8	20.2	(17.1)
Total	$ 684.0	100.0 %	$ 898.4	100.0 %	(23.9) %

AUM by Division

AUM by division (in billions) as of September 30 was as follows:

	2009	% of Total	2008	% of Total	% Change
Americas	$ 484.3	68.9 %	$ 591.5	70.3 %	(18.1) %
International	218.4	31.1	250.4	29.7	(12.8)
Total	$ 702.7	100.0 %	$ 841.9	100.0 %	(16.5) %

The component changes in our AUM by division (in billions) for the three months ended September 30, 2009 was as follows:

	Americas	International	Total
June 30, 2009	$ 457.1	$ 199.8	$ 656.9
Investment funds, excluding liquidity funds			
Sales	5.9	3.8	9.7
Redemptions	(6.0)	(2.8)	(8.8)
Separate account flows, net	(7.2)	(4.2)	(11.4)
Liquidity fund flows, net	(4.5)	6.9	2.4
Net client cash flows	(11.8)	3.7	(8.1)
Market performance and other	39.0	14.9	53.9
September 30, 2009	$ 484.3	$ 218.4	$ 702.7

Investment Performance[5]

Investment performance in the quarter ended September 30, 2009 continued to improve relative to respective benchmarks from the previous quarter. Optimism seemed to dominate the markets as improved economic data further supported expectations of a global economic recovery throughout the quarter. Despite this optimism, the prolonged high jobless rate weighed heavily on investors and policy makers. As of September 30, 2009, for the trailing 1-year, 3-year, 5-year, and 10-year periods approximately 77%, 60%, 71%, and 92%, respectively, of our marketed equity composite[6] assets outpaced their benchmarks. As of September 30, 2008, for the trailing 1-year, 3-year, 5-year, and 10-year periods approximately 43%, 43%, 44%, and 95%, respectively, of our marketed equity composite assets outpaced their benchmarks.

In the fixed income markets, government yields decreased during the quarter as demand continued to be strong overseas and was supported by the Federal Reserve purchase program. With the return of an appetite for risk and credit conditions improving, many sector spreads narrowed, most notably investment-grade and high-yield credit.

The Treasury yield curve flattened from last quarter with the 30-year yield declining 0.28%. The best performing major fixed income sector was high yield as measured by the Barclays U.S. High Yield returning 14.22% and the worst performing fixed income sector was Government bonds as measured by the Barclays U.S. Government Bond returning 2.03%. As of September 30, 2009, for the trailing 1-year, 3-year, 5-year, and 10-year periods approximately 82%, 15%, 23%, and 78%, respectively, of our marketed fixed income composite assets outpaced their benchmarks. As of September 30, 2008, for the trailing 1-year, 3-year, 5-year, and 10-year periods approximately 5%, 11%, 18%, and 77%, respectively, of our fixed income marketed composite assets outpaced their benchmarks.

As of September 30, 2009, for the trailing 1-year, 3-year, 5-year, and 10-year periods 81%, 65%, 62%, and 81%, respectively, of our U.S. long-term mutual fund[7] assets outpaced their Lipper category average. As of September 30, 2008, for the trailing 1-year, 3-year, 5-year, and 10-year periods 45%, 49%, 56%, and 86%, respectively, of our U.S. long-term mutual fund[7] assets outpaced their Lipper category average.

As of September 30, 2009, for the trailing 1-year, 3-year, 5-year, and 10-year periods 81%, 64%, 60%, and 80%, respectively, of our U.S. equity mutual fund[7] assets outpaced their Lipper category average. As of September 30, 2008, for the trailing 1-year, 3-year, 5-year, and 10-year periods 50%, 55%, 46%, and 84%, respectively, of our U.S. equity mutual fund[7] assets outpaced their Lipper category average.

As of September 30, 2009, for the trailing 1-year, 3-year, 5-year, and 10-year periods 80%, 70%, 68%, and 86%, respectively, of our U.S. fixed income mutual fund[7] assets outpaced their Lipper category average. As of September 30, 2008, for the trailing 1-year, 3-year, 5-year, and 10-year periods 36%, 37%, 68%, and 83%, respectively, of our U.S. fixed income mutual fund[7] assets outpaced their Lipper category average.

[5] Index performance in this section includes reinvestment of dividends and capital gains.

[6] 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 September 30, 2009 and 2008, 86% of our equity assets under management in each period, and 83% and 81%, of our fixed income assets under management,

respectively, were in marketed composites.

[7] Source: Lipper Inc. includes open-end, closed-end, and variable annuity funds. As of September 30, 2009 and 2008, the U.S. long-term mutual fund assets represented in the data accounted for 14% and 13%, respectively, of our total assets under management. The performance of our U.S. long-term mutual fund assets is included in the marketed composites.