LEGG MASON, INC.
Form 10-Q
November 01, 2016
Table of Contents

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, 2016
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.
101,006,739 shares of common stock as of the close of business on October 27, 2016.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	September 30, 2016	March 31, 2016
ASSETS		
Current Assets		
Cash and cash equivalents	$570,868	$1,329,126
Cash and cash equivalents of consolidated investment vehicles	2,835	297
Restricted cash	18,688	19,580
Receivables:		
Investment advisory and related fees	425,948	334,922
Other	58,891	74,694
Investment securities	446,610	515,335
Investment securities of consolidated investment vehicles	66,564	48,715
Other	71,072	55,405
Other current assets of consolidated investment vehicles	—	6,970
Total Current Assets	1,661,476	2,385,044
Fixed assets, net	165,765	163,305
Intangible assets, net	4,089,766	3,146,485
Goodwill	1,958,654	1,479,516
Deferred income taxes	209,334	206,797
Other	161,113	139,215
Other assets of consolidated investment vehicles	8,442	84
TOTAL ASSETS	$8,254,550	$7,520,446
LIABILITIES AND STOCKHOLDERS’ EQUITY		
LIABILITIES		
Current Liabilities		
Accrued compensation	$353,216	$430,736
Accounts payable and accrued expenses	199,331	201,572
Short-term borrowings	—	40,000
Contingent consideration	11,315	26,396
Other	110,834	138,301
Other current liabilities of consolidated investment vehicles	6,649	4,548
Total Current Liabilities	681,345	841,553
Deferred compensation	87,698	65,897
Deferred income taxes	301,215	260,386
Contingent consideration	40,738	58,189
Other	162,761	141,886
Long-term debt	2,221,896	1,740,985
TOTAL LIABILITIES	3,495,653	3,108,896
Commitments and Contingencies (Note 9)		
REDEEMABLE NONCONTROLLING INTERESTS	676,164	175,785

STOCKHOLDERS' EQUITY		
Common stock, par value $.10; authorized 500,000,000 shares; issued 100,982,945 shares for September 2016 and 107,011,664 shares for March 2016	10,098	10,701
Additional paid-in capital	2,535,249	2,693,113
Employee stock trust	(25,451)	(26,263)
Deferred compensation employee stock trust	25,451	26,263
Retained earnings	1,612,875	1,576,242
Accumulated other comprehensive loss, net	(98,675)	(66,493)
Total stockholders' equity attributable to Legg Mason, Inc.	4,059,547	4,213,563
Nonredeemable noncontrolling interest	23,186	22,202
TOTAL STOCKHOLDERS' EQUITY	4,082,733	4,235,765
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$8,254,550	$7,520,446

See Notes to Consolidated Financial Statements

3

Table of Contents

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	2015	2016	2015
OPERATING REVENUES				
Investment advisory fees:				
Separate accounts	$233,328	$205,155	$460,181	$413,259
Funds	377,079	359,871	740,542	744,216
Performance fees	41,970	7,902	59,429	26,555
Distribution and service fees	94,545	99,602	185,927	196,462
Other	1,448	556	2,456	1,244
Total Operating Revenues	748,370	673,086	1,448,535	1,381,736
OPERATING EXPENSES				
Compensation and benefits	368,330	282,433	726,955	597,485
Distribution and servicing	128,868	138,930	253,531	288,218
Communications and technology	51,281	49,845	104,013	98,522
Occupancy	30,558	25,716	63,700	51,703
Amortization of intangible assets	6,271	670	11,974	1,327
Other	35,429	42,462	87,174	86,908
Total Operating Expenses	620,737	540,056	1,247,347	1,124,163
OPERATING INCOME	127,633	133,030	201,188	257,573
OTHER NON-OPERATING INCOME (EXPENSE)				
Interest income	1,545	1,229	3,393	2,546
Interest expense	(27,925)	(13,280)	(52,490)	(25,229)
Other income (expense), net	9,975	(28,110)	16,560	(22,399)
Other non-operating income (expense) of consolidated investment vehicles, net	5,206	(2,303)	8,434	(1,896)
Total Other Non-Operating Income (Expense)	(11,199)	(42,464)	(24,103)	(46,978)
INCOME BEFORE INCOME TAX PROVISION	116,434	90,566	177,085	210,595
Income tax provision	29,902	27,647	45,213	52,737
NET INCOME	86,532	62,919	131,872	157,858
Less: Net income (loss) attributable to noncontrolling interests	20,091	(1,400)	31,979	(1,009)
NET INCOME ATTRIBUTABLE TO LEGG MASON, INC.	$66,441	$64,319	$99,893	$158,867
NET INCOME PER SHARE ATTRIBUTABLE TO LEGG MASON, INC. SHAREHOLDERS:				
Basic	$0.63	$0.58	$0.94	$1.43
Diluted	0.63	0.58	0.94	1.42
DIVIDENDS DECLARED PER SHARE	$0.22	$0.20	$0.44	$0.40

See Notes to Consolidated Financial Statements

Table of Contents

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	2015	2016	2015
NET INCOME	$86,532	$62,919	$131,872	$157,858
Other comprehensive income:				
Foreign currency translation adjustment	4,167	(37,176)	(13,023)	(16,512)
Unrealized losses on interest rate swap:				
Unrealized gains (losses) on interest rate swap, net of tax provision (benefit) of $181 and $(1,708), respectively	289	—	(2,718)	—
Reclassification adjustment for losses included in net income, net of tax benefit of $1,505 and $1,708, respectively	2,394	—	2,718	—
Net unrealized losses on interest rate swap	2,683	—	—	—
Net actuarial gains (losses) on defined benefit pension plan	(14,054)	1,922	(19,159)	2,990
Total other comprehensive loss	(7,204)	(35,254)	(32,182)	(13,522)
COMPREHENSIVE INCOME	79,328	27,665	99,690	144,336
Less: Comprehensive income (loss) attributable to noncontrolling interests	18,152	(1,400)	32,038	(1,009)
COMPREHENSIVE INCOME ATTRIBUTABLE TO LEGG MASON, INC.	$61,176	$29,065	$67,652	$145,345

See Notes to Consolidated Financial Statements

Table of Contents

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

	Six Months Ended September 30,	
	2016	2015
STOCKHOLDERS' EQUITY ATTRIBUTABLE TO LEGG MASON, INC.		
COMMON STOCK		
Beginning balance	$10,701	$11,147
Stock options exercised	12	22
Deferred compensation employee stock trust	1	1
Stock-based compensation	37	11
Employee tax withholdings by settlement of net share transactions	(36)	(40)
Shares repurchased and retired	(617)	(320)
Ending balance	10,098	10,821
ADDITIONAL PAID-IN CAPITAL		
Beginning balance	2,693,113	2,844,441
Stock options exercised	3,442	6,073
Deferred compensation employee stock trust	254	250
Stock-based compensation	43,773	35,881
Performance-based Legg Mason restricted share units related to the acquisition of Clarion Partners	11,121	—
Additional tax benefit on Equity Unit exchange in fiscal 2010	—	9,173
Employee tax withholdings by settlement of net share transactions	(11,766)	(21,138)
Shares repurchased and retired	(201,056)	(157,658)
Redeemable noncontrolling interest reclassification for affiliate management equity plans	(3,632)	—
Ending balance	2,535,249	2,717,022
EMPLOYEE STOCK TRUST		
Beginning balance	(26,263)	(29,570)
Shares issued to plans	(255)	(251)
Distributions and forfeitures	1,067	2,143
Ending balance	(25,451)	(27,678)
DEFERRED COMPENSATION EMPLOYEE STOCK TRUST		
Beginning balance	26,263	29,570
Shares issued to plans	255	251
Distributions and forfeitures	(1,067)	(2,143)
Ending balance	25,451	27,678
RETAINED EARNINGS		
Beginning balance	1,576,242	1,690,055
Net Income Attributable to Legg Mason, Inc.	99,893	158,867
Dividends declared	(46,039)	(44,162)
Reclassifications to noncontrolling interest for:		
EnTrustPermal combination	(15,500)	—
Net increase in estimated redemption value of affiliate management equity plans	(1,721)	(826)
Ending balance	1,612,875	1,803,934
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS), NET		
Beginning balance	(66,493)	(60,742)
Net actuarial gains (losses) on defined benefit pension plan	(19,159)	2,990

Foreign currency translation adjustment	(13,023)	(16,512)
Ending balance	(98,675)	(74,264)
TOTAL STOCKHOLDERS' EQUITY ATTRIBUTABLE TO LEGG MASON, INC.	4,059,547	4,457,513
Nonredeemable noncontrolling interest	23,186	—
TOTAL STOCKHOLDERS' EQUITY	$4,082,733	$4,457,513

See Notes to Consolidated Financial Statements

6

Table of Contents

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

	Six Months Ended September 30,	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$131,872	$157,858
Adjustments to reconcile Net Income to net cash provided by operations:		
Depreciation and amortization	40,342	27,534
Accretion and amortization of securities discounts and premiums, net	2,097	424
Stock-based compensation, including $15,200 related to the Clarion Partners affiliate management equity plan in April 2016	54,981	37,041
Net unrealized (gains) losses on investments	(21,382)	39,024
Net (gains) losses and earnings on investments	3,391	(22,336)
Net (gains) losses of consolidated investment vehicles	(8,434)	1,896
Deferred income taxes	30,307	46,749
Contingent consideration fair value adjustments	(25,000)	—
Other	500	701
Decrease (increase) in assets:		
Investment advisory and related fees receivable	(17,298)	37,970
Net sales (purchases) of trading and other investments	25,002	(12,373)
Other receivables	(4,030)	(10,884)
Other assets	(11,290)	16,892
Other assets of consolidated investment vehicles	56,672	(4,925)
Increase (decrease) in liabilities:		
Accrued compensation	(102,908)	(134,114)
Deferred compensation	22,092	12,123
Accounts payable and accrued expenses	(3,423)	(18,376)
Other liabilities	(37,733)	(23,355)
Other liabilities of consolidated investment vehicles	2,101	(141)
CASH PROVIDED BY OPERATING ACTIVITIES	$137,859	$151,708

Table of Contents

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

	Six Months Ended September 30, 2016	2015
CASH FLOWS FROM INVESTING ACTIVITIES		
Payments for fixed assets	$(18,684)	$(19,858)
Business acquisitions, net of cash acquired of $33,547	(1,009,928)	—
Change in restricted cash	436	18,438
Proceeds from sales and maturities of investments	2,436	9,465
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	(1,025,740)	8,045
CASH FLOWS FROM FINANCING ACTIVITIES		
Net decrease in short-term borrowings	(40,000)	—
Payment of contingent consideration	(6,587)	(22,765)
Proceeds from issuance of long-term debt	500,000	—
Debt issuance costs	(17,639)	—
Issuances of common stock for stock-based compensation	3,709	6,346
Employee tax withholdings by settlement of net share transactions	(11,802)	(21,178)
Repurchases of common stock	(201,673)	(157,978)
Dividends paid	(44,103)	(40,383)
Net subscriptions/(redemptions) and distributions attributable to noncontrolling interests	(52,530)	33,141
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	129,375	(202,817)
EFFECT OF EXCHANGE RATES ON CASH	248	(7,553)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(758,258)	(50,617)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	1,329,126	669,552
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$570,868	$618,935
SUPPLEMENTAL DISCLOSURE		
Cash paid for:		
Income taxes, net of refunds of $(754) and $(2,018), respectively	$11,025	$17,125
Interest	45,485	24,551

See Notes to Consolidated Financial Statements

Table of Contents

LEGG MASON, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in thousands, except per share amounts or unless otherwise noted)
September 30, 2016
(Unaudited)

1. Interim Basis of Reporting

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

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

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

2. Significant Accounting Policies

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

Certain of the investment products Legg Mason sponsors and manages are considered to be variable interest entities ("VIEs") (as further described below) while others are considered to be voting rights entities ("VREs") subject to traditional consolidation concepts based on ownership rights. Sponsored investment products that are considered VREs are consolidated if Legg Mason has a controlling financial interest in the investment vehicle, absent substantive investor rights to replace the manager of the entity (kick-out rights). Legg Mason may fund the initial cash investment in certain VRE investment products to generate an investment performance track record in order to attract third-party investors in the product. Legg Mason's initial investment in a new product typically represents 100% of the ownership in that product. As further discussed below, these “seed capital investments” are consolidated as long as Legg Mason maintains a controlling financial interest in the product, but they are not designated as CIVs by Legg Mason unless the investment is longer-term. As of September 30, 2016, March 31, 2016, and September 30, 2015, no consolidated VREs were designated as CIVs.

A VIE is an entity which does not have adequate equity to finance its activities without additional subordinated financial support; or the equity investors, as a group, do not have the normal characteristics of equity investors for a potential controlling financial interest. Legg Mason must consolidate any VIE for which it is deemed to be the primary beneficiary.

Table of Contents

Updated Consolidation Accounting Guidance
Effective April 1, 2016, Legg Mason adopted updated consolidation accounting guidance on a modified retrospective basis. Under the updated guidance, if limited partners or similar equity holders in a sponsored investment vehicle structured as a limited partnership or a similar entity do not have either substantive kick-out or substantive participation rights over the general partner, the entities are VIEs. As a sponsor and manager of an investment vehicle, Legg Mason may be deemed a decision maker under the accounting guidance. If the fees paid to a decision maker are market-based, such fees are not considered variable interests in a VIE. Additionally, if employee interests in a sponsored investment vehicle are not made to circumvent the consolidation guidance and are not financed by the sponsor, they are not included in the variable interests assessment, and are not included in the primary beneficiary determination.

A decision maker is deemed to be a primary beneficiary of a VIE if it has the power to direct activities that most significantly impact the economic performance of the VIE and the obligation to absorb losses or receive benefits from variable interests that could be significant to the VIE. In determining whether it is the primary beneficiary of a VIE, Legg Mason considers both qualitative and quantitative factors such as the voting rights of the equity holders, guarantees, and implied relationships. If a fee paid to a decision maker is not market-based, it will be considered in the primary beneficiary determination.

The adoption of this accounting guidance resulted in certain sponsored investment products that are foreign mutual fund trusts that were previously accounted for as VREs to be evaluated as VIEs, and the consolidation of nine funds as of June 30, 2016, which were also designated as CIVs. Under the updated accounting guidance, Legg Mason also concluded it was the primary beneficiary of one sponsored investment fund VIE managed by EnTrust Capital ("EnTrust"), which was also consolidated and designated a CIV. The adoption also resulted in the deconsolidation of 13 employee-owned funds, as Legg Mason no longer has a variable interest in those funds.

As of September 30, 2016, Legg Mason no longer held a significant financial interest in four foreign mutual funds, and therefore concluded it was no longer the primary beneficiary. As a result, these four funds were not consolidated as of September 30, 2016. In addition, during the quarter ended September 30, 2016, Legg Mason concluded that it was the primary beneficiary of one additional foreign mutual fund trust, which was consolidated and designated as a CIV.

Legg Mason also concluded it was the primary beneficiary of one sponsored investment fund VIE, which was consolidated (and designated as a CIV) as of September 30, 2016. This sponsored investment fund was also consolidated under prior accounting guidance, as further discussed below.

The adoption of the updated accounting guidance did not have a material impact on the Consolidated Balance Sheet as of September 30, 2016.

Prior Consolidation Accounting Guidance
Under prior accounting guidance, for most sponsored investment fund VIEs deemed to be investment companies, including money market funds, Legg Mason determined it was the primary beneficiary of a VIE if it absorbed a majority of the VIE's expected losses, or received a majority of the VIE's expected residual returns, if any. Legg Mason's determination of expected residual returns excluded gross fees paid to a decision maker if certain criteria relating to the fees were met. In determining whether it was the primary beneficiary of a VIE, Legg Mason considered both qualitative and quantitative factors such as the voting rights of the equity holders, economic participation of all parties (including how fees were earned and paid to Legg Mason), related party ownership, guarantees, and implied relationships.

For other sponsored investment funds that do not meet the investment company criteria, Legg Mason determined it was the primary beneficiary of a VIE if it had 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 be significant to the VIE.

Legg Mason concluded it was the primary beneficiary of one sponsored investment fund VIE, that was consolidated as of March 31, 2016, and September 30, 2015, despite significant third-party investments in this product. Also, as of both March 31, 2016, and September 30, 2015, Legg Mason concluded it was the primary beneficiary of 14 employee-owned funds it sponsors which were consolidated and designated as CIVs. As discussed above, effective April 1, 2016, under new accounting guidance, all but one of those employee-owned funds no longer qualified as VIEs, and 13 of those employee-owned funds were therefore deconsolidated.

Table of Contents

As of September 30, 2015, Legg Mason had a variable interest in three collateralized loan obligations ("CLOs"). Legg Mason concluded it was not the primary beneficiary of these CLOs, which were not consolidated, as it held no equity interest in these investment products and the level of fees they were expected to pay to Legg Mason was insignificant.

See Notes 4 and 13 for additional information related to VIEs.

Fair Value Measurements

Legg Mason's financial instruments are measured and reported at fair value and are classified and disclosed in one of the following categories (the "fair value hierarchy"):

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 and certain derivative instruments.

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.

Level 3 — Financial instruments for which values are based on unobservable inputs, including those for which there is little or no market activity.

As a result of the acquisition of Clarion Partners, LLC ("Clarion Partners") in April 2016, Legg Mason holds investments in real estate fund partnerships and limited liability companies, which are classified as Level 3. The fair values of investments in real estate funds are prepared giving consideration to the income, cost and sales comparison approaches of estimating property value. The income approach estimates an income stream for a property and discounts this income plus a reversion (presumed sale) into a present value at a risk adjusted rate. Yield rates and growth assumptions utilized in this approach are derived from market transactions as well as other financial and industry data. The discount rate and the exit capitalization rate are significant inputs to these valuations. These rates are based on the location, type and nature of each property, and current and anticipated market conditions. The cost approach estimates the replacement cost of the building less physical depreciation plus the land value. The sales comparison approach compares recent transactions to the appraised property. Adjustments are made for dissimilarities which typically provide a range of value. Many factors are also considered in the determination of fair value including, but not limited to, the operating cash flows and financial performance of the properties, property types and geographic locations, the physical condition of the asset, prevailing market capitalization rates, prevailing market discount rates, general economic conditions, economic conditions specific to the market in which the assets are located, and any specific rights or terms associated with the investment. Because of the inherent uncertainties of valuation, the values may materially differ from the values that would be determined by negotiations held between parties in a sale transaction.

See Note 4 for additional information regarding fair value measurements.

Contingent Consideration Liabilities

In connection with business acquisitions, Legg Mason may be required to pay additional future consideration based on the achievement of certain designated financial metrics. Legg Mason estimates the fair value of these potential future obligations at the time a business combination is consummated and records a Contingent consideration liability in the Consolidated Balance Sheet.

Legg Mason accretes contingent consideration liabilities to the expected payment amounts over the related earn-out terms until the obligations are ultimately paid, resulting in Interest expense in the Consolidated Statements of Income.

If the expected payment amounts subsequently change, the contingent consideration liabilities are (reduced) or increased in the current period, resulting in a (gain) or loss, which is reflected within Other operating expense in the Consolidated Statements of Income. See Notes 3 and 9 for additional information regarding contingent consideration liabilities.

Noncontrolling Interests

Noncontrolling interests include affiliate minority interests, third-party investor equity in consolidated sponsored investment products, and vested affiliate management equity plan interests. For CIVs and other consolidated sponsored investment products with third-party investors, the related noncontrolling interests are classified as redeemable noncontrolling interests

Table of Contents

if investors in these funds may request withdrawals at any time. Also included in redeemable noncontrolling interests are vested affiliate management equity plan and affiliate minority interests for which the holder may, at some point, request settlement of their interests. Redeemable noncontrolling interests are reported in the Consolidated Balance Sheets at their estimated settlement values. When settlement is not expected to occur until a future date, changes in the expected settlement value are recognized over the settlement period as an adjustment to retained earnings. Nonredeemable noncontrolling interests include vested affiliate management equity plan interests that do not permit the holder to request settlement of their interests. Nonredeemable noncontrolling interests are reported in the Consolidated Balance Sheets at their issuance value, together with undistributed net income allocated to noncontrolling interests.

Legg Mason estimates the settlement value of noncontrolling interests as their fair value. For consolidated sponsored investment products, where the investor may request withdrawal at any time, fair value is based on market quotes of the underlying securities held by the investment products. For affiliate minority interests and management equity plan interests, fair value reflects the related total business enterprise value, after appropriate discounts for lack of marketability and control. There may also be features of these equity interests, such as dividend subordination, that are contemplated in their valuations. The fair value of option-like management equity plan interests also relies on Black-Scholes option pricing model calculations.

Net income (loss) attributable to noncontrolling interests in the Consolidated Statements of Income includes the share of net income of the respective subsidiary allocated to the minority interest holders.

See Note 11 for additional information regarding noncontrolling interests.

Accumulated Other Comprehensive Loss, Net
There were no significant amounts reclassified from Accumulated other comprehensive loss, net, to the Consolidated Statements of Income for the three and six months ended September 30, 2016 or 2015, except for $237 and $764 realized on the settlement and termination of an interest rate swap for the three and six months ended September 30, 2016, respectively, as further described in Note 7.

Income Tax Provision
Noncontrolling interests in EnTrustPermal Group Holdings, LLC ("EnTrustPermal"), Clarion Partners, and Royce & Associates ("Royce") are structured as partnerships that pass related tax attributes to the related noncontrolling interest holders. As such, the consolidated financial statements do not generally include any tax provision/benefit associated with the net income allocated to these noncontrolling interests, which caused the effective tax rate to be reduced by 6.7 percentage points and 4.4 percentage points for the three and six months ended September 30, 2016, respectively.

In September 2016, the U.K. Finance Act 2016 was enacted, which reduced the main U.K. corporate tax rate effective on April 1, 2020 from 18% to 17%. The reduction in the U.K. corporate tax rate resulted in a tax benefit of $4,055, recognized in the three months ended September 30, 2016, as a result of the revaluation of certain existing deferred tax assets and liabilities at the new rate, which reduced the effective tax rate by 3.5 percentage points and 2.3 percentage points for the three and six months ended September 30, 2016, respectively. During the three months ended September 30, 2016, Legg Mason also recognized income tax benefits of $2,200 as a result of reserve adjustments related to the conclusion of certain tax examinations, which reduced the effective tax rate by 1.9 percentage points and 1.2 percentage points for the three and six months ended September 30, 2016, respectively.

During the three months ended September 30, 2015, Legg Mason recognized income tax benefits of $7,026 as a result of reserve adjustments related to the conclusion of certain tax examinations, and during the three months ended June 30, 2015, Legg Mason recognized an income tax benefit of $17,527 as a result of an increase in the value of deferred tax assets due to changes in the New York City tax code. These tax benefits reduced the effective income tax rate by

7.8 percentage points and 11.7 percentage points for the three and six months ended September 30, 2015, respectively.

Recent Accounting Developments

In August 2016, the Financial Accounting Standards Board ("FASB") updated the guidance on the classification of certain cash receipts and cash payments in the statement of cash flows. The updated guidance addresses the reporting classification of several specific cash flow items, including debt prepayment or extinguishment costs, contingent consideration payments, and distributions received from equity method investees, with the objective of reducing diversity in practice where no specific guidance exists, or current guidance is unclear. The updated guidance will be effective in fiscal 2019, with the option for early adoption. Legg Mason is currently evaluating the impact of its adoption.

Table of Contents

In February 2016, the FASB updated the guidance on accounting for leases. The updated guidance requires that a lessee shall recognize the assets and liabilities that arise from lease transactions. A lessee will recognize a right-of-use asset to use the underlying asset and a liability representing the lease payments. The updated guidance also requires an evaluation at the inception of a service or other contract, to determine whether the contract is or contains a lease. The guidance will be effective in fiscal 2020. Legg Mason is evaluating the impact of its adoption.

In May 2014, the FASB updated the guidance on revenue recognition. The updated guidance improves comparability and removes inconsistencies in revenue recognition practices across entities, industries, jurisdictions, and capital markets. In March 2016, the FASB further updated the revenue guidance on determining whether to report revenue on a gross versus net basis. The updated guidance clarifies how entities evaluate principal versus agent aspects of the revenue recognition guidance issued in May 2014. The evaluation will require entities to identify all goods or services to be provided to the customer, and determine whether they obtain control of the good or service before it is transferred to the customer, where control would suggest a principal relationship, which would be accounted for on a gross basis. These updates are effective for Legg Mason in fiscal 2019. Legg Mason is evaluating the impact of its adoption.

Table of Contents

3. Acquisitions

The following table presents a summary of the acquisition-date fair values of the assets acquired and liabilities assumed for each of Legg Mason's significant recent acquisitions:

	EnTrust Capital(1)	Clarion Partners(1)	RARE Infrastructure Limited	Martin Currie (Holdings) Limited	QS Investors Holdings, LLC
Acquisition Date	May 2, 2016	April 13, 2016	October 21, 2015	October 1, 2014	May 31, 2014
Purchase price					
Cash	$400,000	$631,476	$ 213,739	$202,577	$ 11,000
Estimated contingent consideration	—	—	25,000	75,211	