

# Second Quarter Review October 26, 2012

Joseph A. Sullivan  
Interim Chief Executive Officer

Peter H. Nachtwey  
Chief Financial Officer



# Forward-Looking Statements

This presentation may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements are not statements of facts or guarantees of future performance, and are subject to risks, uncertainties and other factors that may cause actual results to differ materially from those discussed in the statements.

For a discussion of these risks and uncertainties, please see “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in the Company’s Annual Report on Form 10-K for the fiscal year ended March 31, 2012 and in the Company’s quarterly reports on Form 10-Q.

# Second Quarter FY 2013 Earnings Call

- Opening and Overview - Joe Sullivan
- Financials - Pete Nachtwey
- Closing Comments - Joe Sullivan
- Questions & Answers

# Assets Under Management (\$ billions)

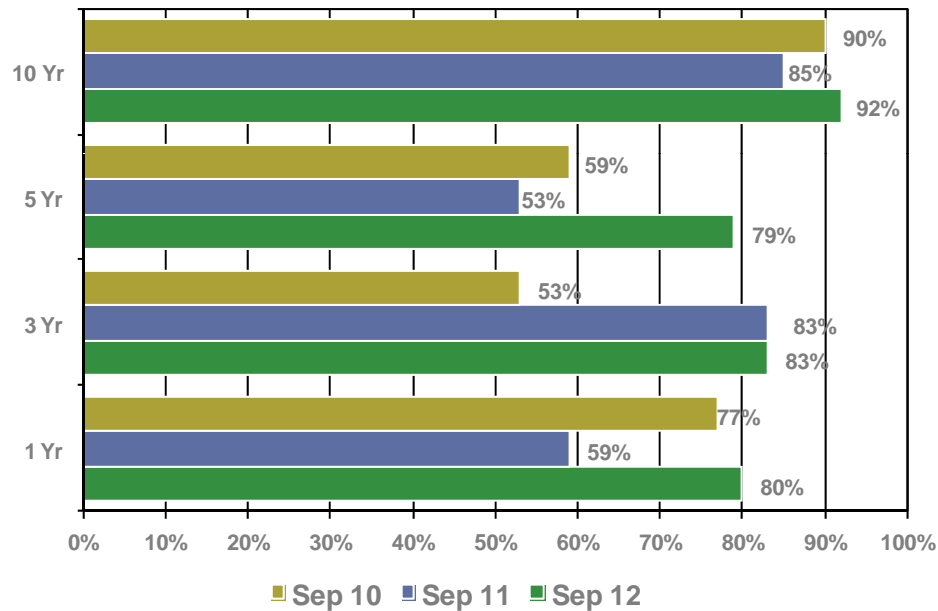
AUM by Affiliate <sup>1</sup>	Sep 12 AUM	Jun 12 AUM	Sep 11 AUM	% Change vs.	
				Jun 12	Sep 11
Western Asset	\$ 459.0	\$ 444.7	\$ 433.4	3 %	6 %
Royce & Associates	36.4	36.1	33.3	1 %	9 %
ClearBridge <sup>2</sup>	59.0	56.1	49.8	5 %	19 %
Permal Group	16.8	17.2	18.7	(2) %	(10) %
Brandywine	41.4	39.0	31.2	6 %	33 %
Batterymarch	14.6	15.6	16.8	(6) %	(13) %

<sup>1</sup> Primary affiliates ordered by contribution to fiscal year 2013 pre-tax earnings

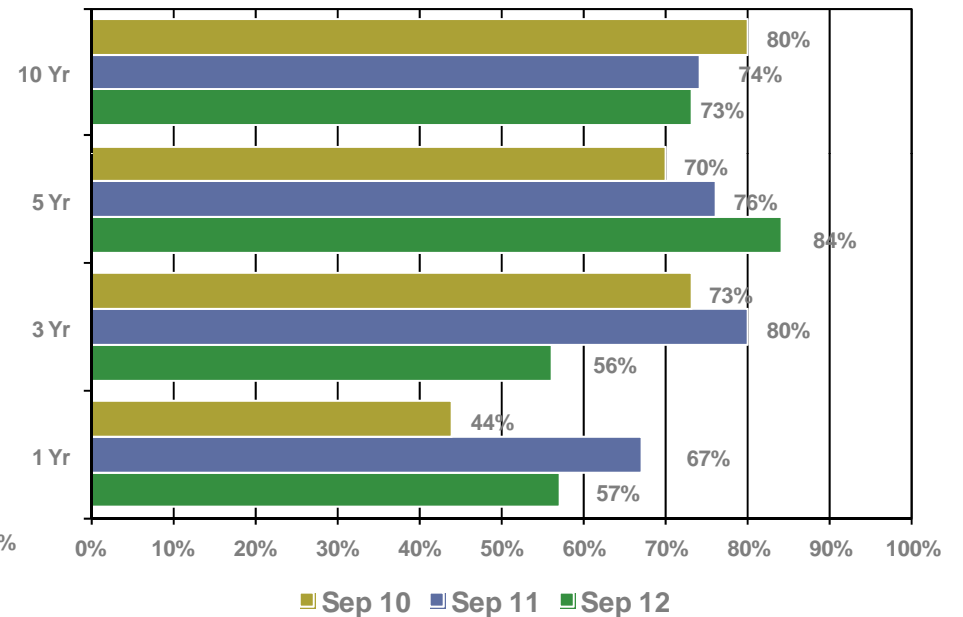
<sup>2</sup> Includes Global Currents Investment Management, LLC which operates as a division of ClearBridge

# Investment Performance

% of Strategy AUM beating Benchmark<sup>1</sup>



% of Long-Term U.S. Fund Assets beating Lipper Category Average<sup>2</sup>



<sup>1</sup> See appendix for details regarding strategy performance

<sup>2</sup> Includes open-end, closed-end, and variable annuity funds. Source: Lipper Inc. and Morningstar

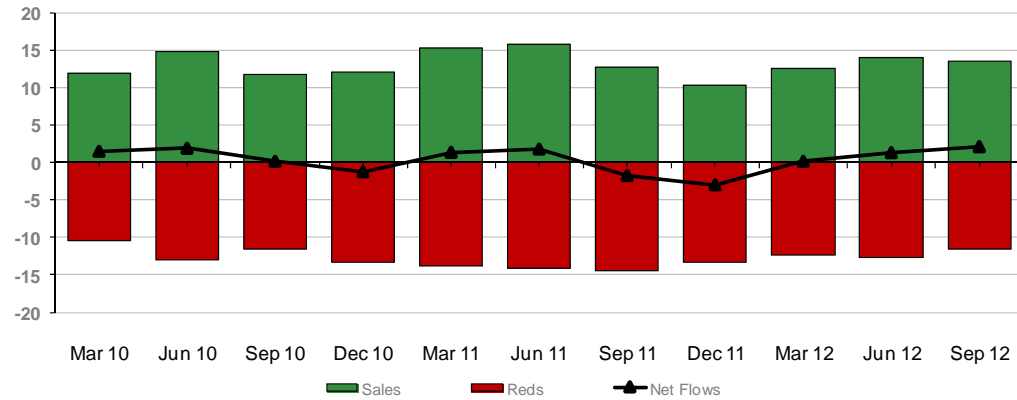
Past performance is no guarantee of future results. The information shown above does not reflect the performance of any specific fund. Individual fund performance will differ

# Global Distribution

## Total Long-Term AUM: \$224B

- Net inflows in eight of last eleven quarters
- Fifteen consecutive quarters of net inflows for International Distribution

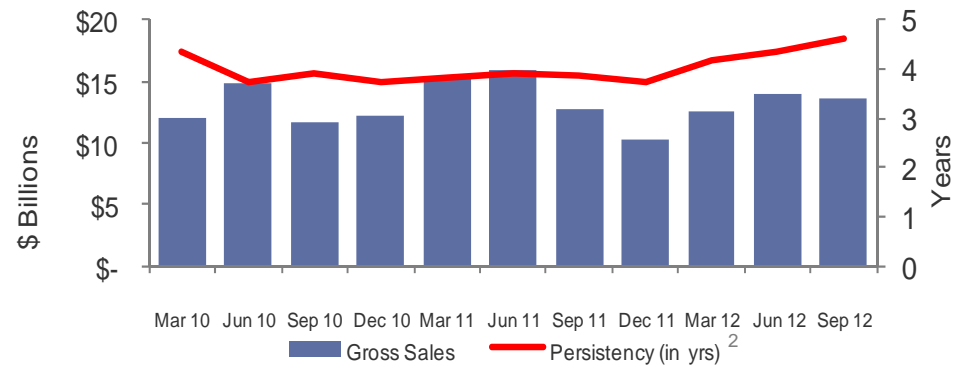
Quarterly Net Flows (\$B)<sup>1</sup>



## Top Funds Driving Gross Sales FYTD

- ClearBridge Energy MLP Total Return Fund
- Legg Mason Australian High Dividend Equity Fund
- Legg Mason Brandywine Global Fixed Income Fund
- Legg Mason Brandywine Global Opportunities Bond Fund
- Legg Mason ClearBridge Aggressive Growth Fund
- LM Australian Bond Fund
- Royce Premier Fund
- Western Core Bond Fund
- Western Asset Core Plus Bond Fund
- Western Asset Intermediate-Term Municipals Fund
- Western Asset Managed Municipals Fund
- Western Asset Short Duration Municipal Income Fund

LMGD Persistency/Sales Trend



<sup>1</sup> Represents long-term sales, redemptions and net flows by Legg Mason's centralized global distribution platform

<sup>2</sup> Expected life of an asset based on current redemption rates

# Financial Highlights Second Quarter FY 2013

- Net income of \$81M, \$0.60 per diluted share
  - Includes UK Tax benefit of \$18M or \$0.13 per diluted share
- Adjusted income<sup>1</sup> increased to \$100M or \$0.75 per diluted share, compared to \$89M or \$0.64 per diluted share in prior quarter
  - Increase primarily driven by absence of fund launch costs in current quarter and change in mark to market on corporate investments
- Average AUM of \$639B, up \$4B from prior quarter
- Operating revenues \$640M, up \$10M or 1.5% from prior quarter
  - Increase due to one additional day, higher average AUM and performance fees
- Operating expenses of \$561M increased \$6M or 1.1% from prior quarter due to:
  - Increase in mark to market on deferred comp and seed investments
  - Increase in compensation under revenue share arrangements due to increased revenue
  - Partially offset by fund launch costs in the prior quarter
- Operating income \$80M, operating margin improved to 12.5%
- Operating income, as adjusted<sup>1</sup>, \$105M, operating margin, as adjusted<sup>1</sup>, 21.2%

# Operating Results Second Quarter FY 2013

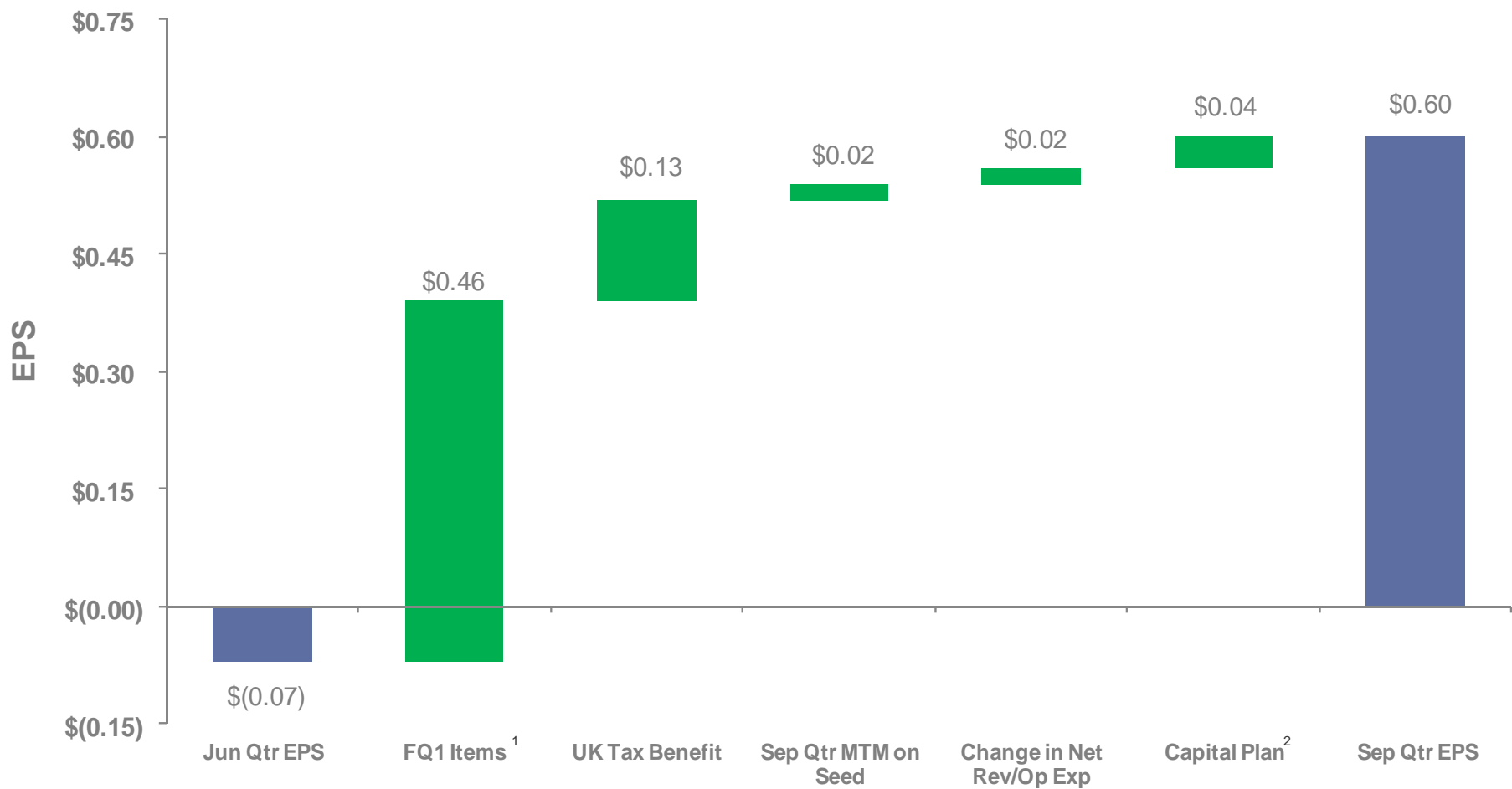
(\$ millions, except per share amounts)	Sep 12 Qtr	Jun 12 Qtr	Sep 11 Qtr	\$ Change vs.	
				Jun 12	Sep 11
<b>Operating Revenues</b>	\$ 640.3	\$ 630.7	\$ 669.9	\$ 9.6	\$ (29.6)
<b>Operating Expenses</b>	560.6	554.6	563.0	6.0	(2.4)
<b>Operating Income</b>	79.7	76.1	106.9	3.6	(27.2)
<b>Net Income (loss)</b>	80.8	(9.5)	56.7	90.3	24.1
<b>Diluted EPS</b>	0.60	(0.07)	0.39	0.67	0.21
<b>Adjusted Income<sup>1</sup></b>	100.1	88.6	87.6	11.5	12.5
<b>Adjusted Income per diluted share<sup>1</sup></b>	0.75	0.64	0.61	0.11	0.14
<b>Operating Margin, as adjusted<sup>1</sup></b>	21.2%	16.9%	21.3%		
<b>Effective Tax Rate GAAP<sup>2</sup></b>	16.8%	27.8%	(2.9)%		

<sup>1</sup> See Appendix for GAAP reconciliation

<sup>2</sup> Includes the impact of Consolidated Investment Vehicles (CIVs) of 0%, (7.2%), and 0% in Sep 12, Jun 12, and Sep 11, respectively



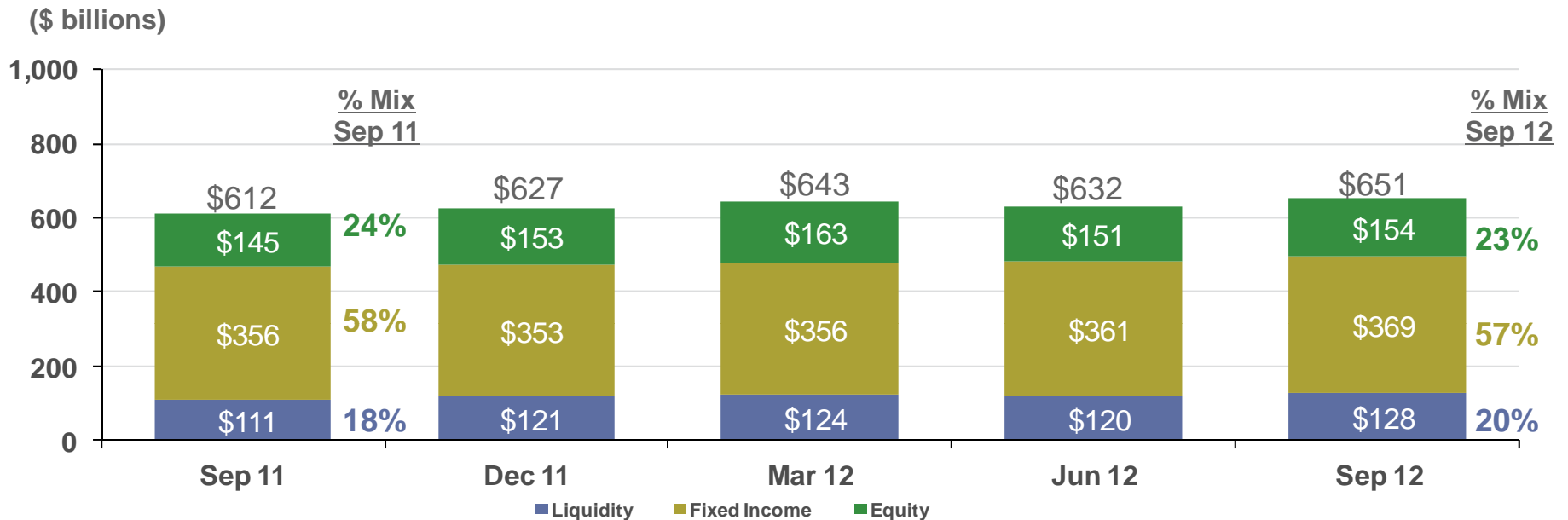
# Second Quarter Earnings Per Share Rollforward



<sup>1</sup> Includes prior quarter fund launch costs, debt extinguishment, and MTM on seed

<sup>2</sup> Includes reduced GAAP interest and share repurchase impact

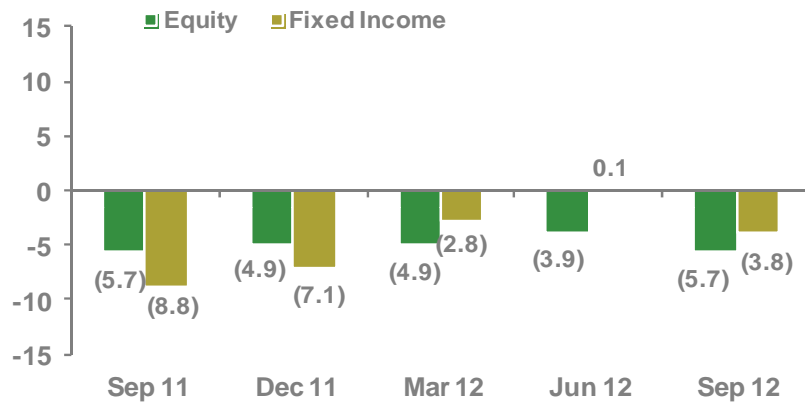
# Assets Under Management by Asset Class



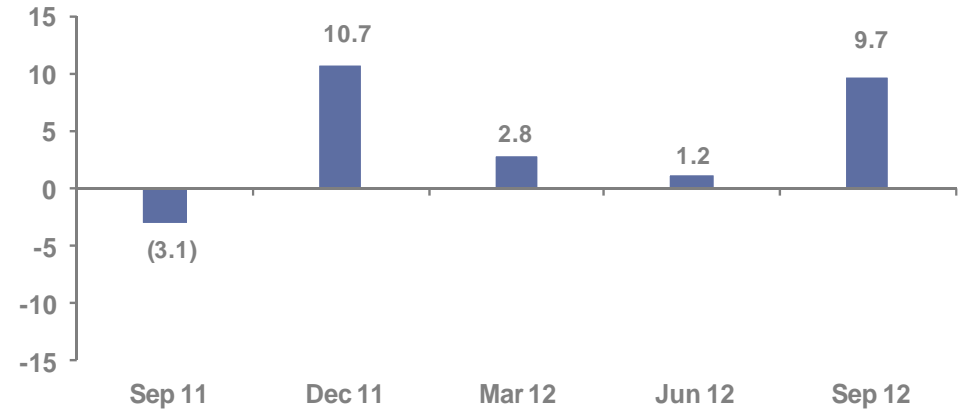
- Market appreciation \$20.7B
  - Equity market appreciation \$8.0B and Fixed Income market appreciation \$12.6B
- Average AUM of \$639B increased \$4B from prior quarter
- Quarter included \$2.0B of liquidity AUM transferred to Morgan Stanley Wealth Management

# Net Flows

## Long-Term Net Flows (\$B)



## Liquidity Net Flows (\$B)

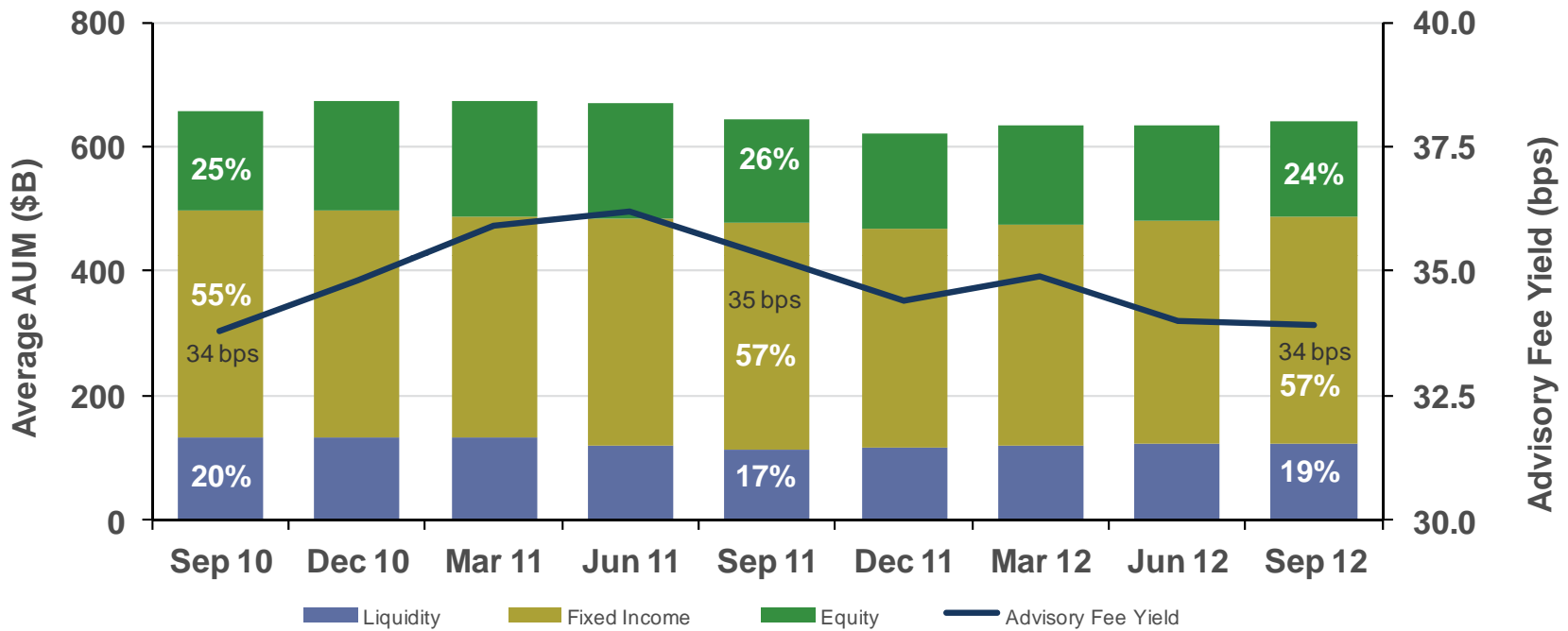


Organic Growth Rate

Period	Organic Growth Rate
Sep 11	-10.5%
Dec 11	-9.5%
Mar 12	-6.1%
Jun 12	-2.9%
Sep 12	-7.4%

- Fixed Income fund inflows of \$1.7B were offset by \$5.5B of separate account outflows, largely in low fee accounts
- Equity outflows were driven by emerging market, small cap, and HNWI alternatives
- Increased liquidity inflows driven by non-US institutional funds

# Advisory Fee Yield / Average AUM



- Advisory fee yield remained relatively flat compared to prior quarter

# Operating Expenses

(\$ millions)	Sep 12	Jun 12	% Chg	Sep 11	% Chg
Compensation and benefits	\$ 302.5	\$ 270.3	12%	\$ 270.0	12%
Distribution and servicing	145.1	169.8	(15%)	160.4	(10%)
Communications and technology	35.8	37.6	(5%)	41.6	(14%)
Occupancy	27.3	30.3	(10%)	35.7	(24%)
Amortization of intangible assets	3.5	3.5	0%	5.5	(36%)
Other	46.4	43.1	7%	49.8	(7%)
Total Operating Expenses	<u>\$ 560.6</u>	<u>\$ 554.6</u>	1%	<u>\$ 563.0</u>	(0%)

- Distribution and servicing decrease due to fund launch costs in prior quarter
- Communications and technology expenses decreased due to renegotiation of vendor contracts and lower consulting fees
- Occupancy decrease due to a \$3.2M lease reserve reduction in current quarter
- Other expenses increased due to annual directors fees and affiliate related legal costs (offset in compensation), partially offset by lower T&E

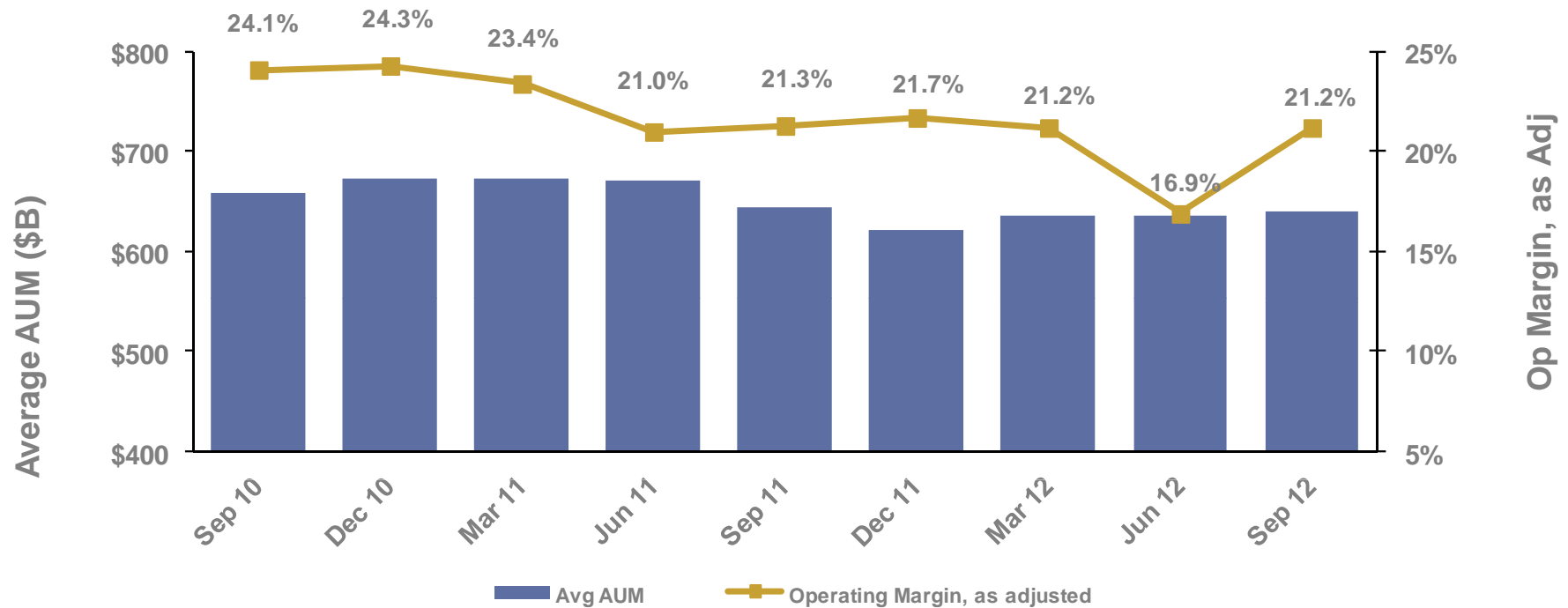
# Compensation and Benefits

(\$ millions)	Sep 12	% of Net Rev. <sup>1</sup>	Jun 12	% of Net Rev. <sup>1</sup>	\$ Change
Salary and incentives	\$ 227.3	46%	\$ 210.9	46%	\$ 16.4
Benefits and payroll taxes	46.4	9%	58.0	12%	(11.6)
<b>Subtotal Compensation and benefits</b>	<b>273.7</b>	<b>55%</b>	<b>268.9</b>	<b>58%</b>	<b>4.8</b>
Management transition costs and severance	4.4	1%	0.2	0%	4.2
MTM deferred comp. and seed investments	24.4	5%	1.2	0%	23.2
Total Compensation and Benefits	\$ 302.5	61%	\$ 270.3	58%	32.2

- Total compensation and benefits increased due to mark to market on deferred compensation and seed investments, net revenue increases and management transition costs
- Management transition costs included in the current quarter are \$4.1M
- Fund launch costs in June quarter had a 3% impact on the comp ratio

<sup>1</sup> Net revenue is equal to operating revenues, as adjusted

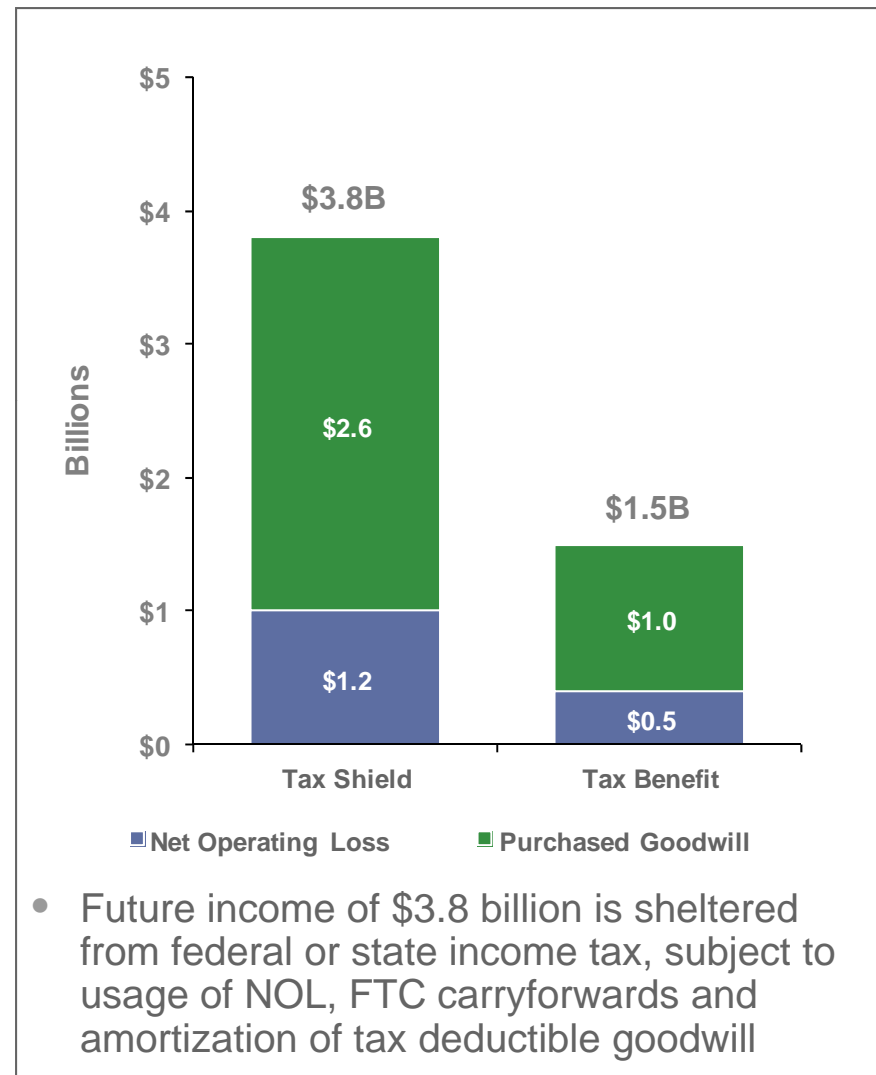
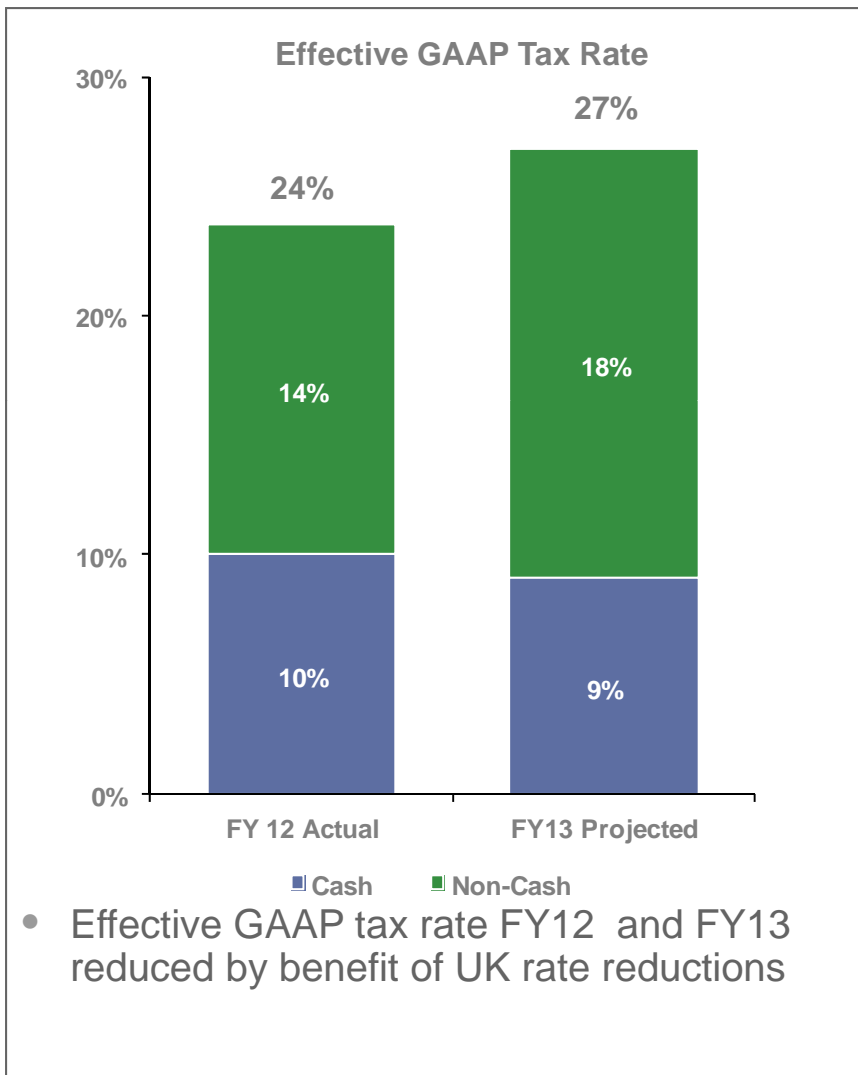
# Operating Margin, as Adjusted



- Prior quarter included the impact of fund launch costs on operating margin, as adjusted, of approximately 4%

Note: See Appendix for GAAP reconciliation

# Significant Tax Benefit

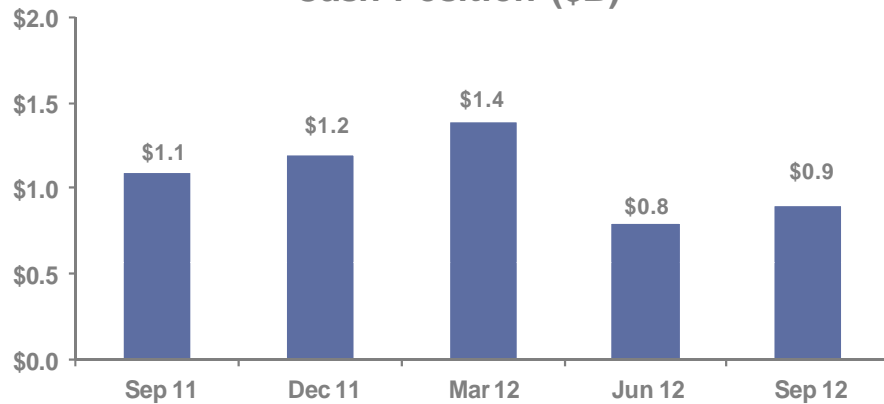


Data as of September 30, 2012

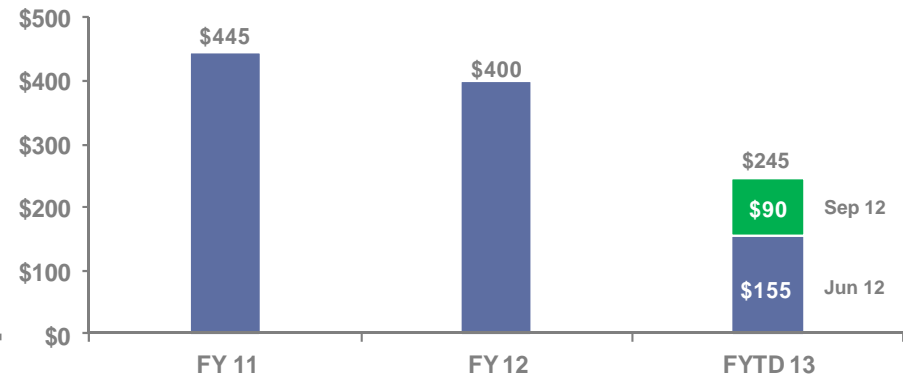


# Cash Utilization & Balance Sheet Improvement

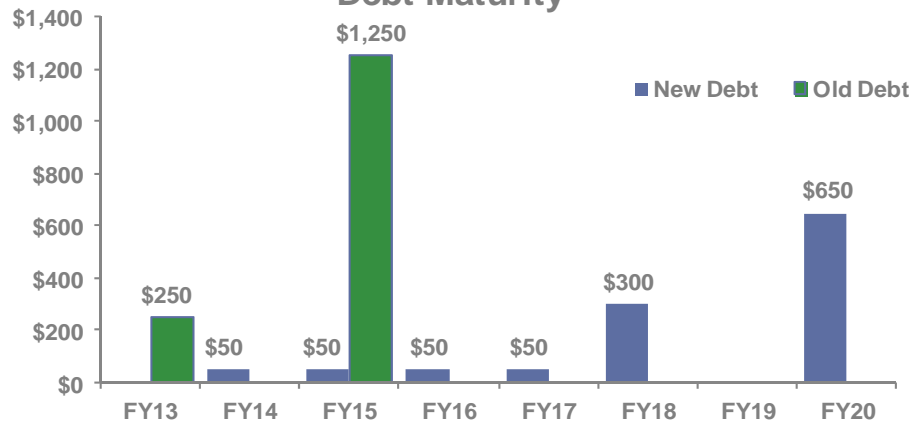
### Cash Position (\$B)



### Share Repurchases (\$M)



### Debt Maturity



- Last quarter repurchased \$1.25B senior convertible notes using \$250M from bank line, proceeds of \$650M 7-year senior bond offering and \$350M of cash on hand
- These actions reduced outstanding debt, extended debt maturities, and locked in rates at historical lows, providing additional optionality

# Driving Shareholder Value

- Strong foundation for the future
  - Global firm with distinct affiliate businesses and respected brands
  - Diversified across asset classes, geographies, clients and channels
  - Strong performance across all periods
  - Solid balance sheet and cash position
  - Proven ability to return capital to shareholders
- Areas of focus
  - Long term flows
  - Investment products and strategies
  - Operating efficiencies
- Primary goals
  - Revenue growth
  - Margin expansion and EPS leverage

# Appendix

# Appendix – GAAP Reconciliation Adjusted Income<sup>1</sup>

	Quarters Ended		
	Sep 12	Jun 12	Sep 11
(\$ millions, except per share amounts)			
<b>Net Income (Loss) Attributable to Legg Mason, Inc.</b>	\$ 80.8	\$ (9.5)	\$ 56.7
Plus (less):			
Amortization of intangible assets	3.5	3.5	5.5
Loss on extinguishment of 2.5% senior notes	-	54.9	-
Deferred income taxes on intangible assets:			
Tax amortization benefit	33.9	33.9	34.0
U.K. tax rate adjustment	(18.1)	-	(18.3)
Imputed interest on convertible debt (2.5% senior notes)	-	5.8	9.7
<b>Adjusted Income</b>	<b>\$ 100.1</b>	<b>\$ 88.6</b>	<b>\$ 87.6</b>
<b>Net Income (Loss) per Diluted Share Attributable to Legg Mason, Inc. Common Shareholders</b>	\$ 0.60	\$ (0.07)	\$ 0.39
Plus (less):			
Amortization of intangible assets	0.03	0.03	0.04
Loss on extinguishment of 2.5% senior notes	-	0.40	-
Deferred income taxes on intangible assets:			
Tax amortization benefit	0.25	0.24	0.24
U.K. tax rate adjustment	(0.13)	-	(0.13)
Imputed interest on convertible debt (2.5% senior notes)	-	0.04	0.07
<b>Adjusted Income per Diluted Share</b>	<b>\$ 0.75</b>	<b>\$ 0.64</b>	<b>\$ 0.61</b>

<sup>1</sup> See explanations for Use of Supplemental Data as Non-GAAP Performance Measures in earnings release.

# Appendix – GAAP Reconciliation

## Operating Margin, as adjusted<sup>1</sup>

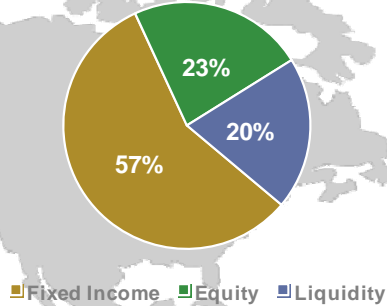
(\$ millions)	Quarters Ended								
	Sep 10	Dec 10	Mar 11	Jun 11	Sep 11	Dec 11	Mar 12	Jun 12	Sep 12
<b>Operating Revenues, GAAP basis</b>	\$ 674.8	\$ 721.9	\$ 713.4	\$ 717.1	\$ 669.9	\$ 627.0	\$ 648.6	\$ 630.7	\$ 640.3
Plus (less):									
Operating revenues eliminated upon consolidation of investment vehicles	1.0	1.2	1.2	1.1	0.6	0.8	0.7	0.6	0.6
Distribution and servicing expense excluding consolidated investment vehicles	<u>(165.8)</u>	<u>(187.4)</u>	<u>(174.8)</u>	<u>(180.7)</u>	<u>(160.4)</u>	<u>(148.3)</u>	<u>(160.3)</u>	<u>(169.8)</u>	<u>(145.1)</u>
<b>Operating Revenues, as Adjusted</b>	<u>\$ 509.9</u>	<u>\$ 535.7</u>	<u>\$ 539.8</u>	<u>\$ 537.4</u>	<u>\$ 510.1</u>	<u>\$ 479.5</u>	<u>\$ 489.0</u>	<u>\$ 461.5</u>	<u>\$ 495.8</u>
<b>Operating Income, GAAP basis</b>	\$ 87.9	\$ 97.0	\$ 99.1	\$ 100.4	\$ 106.9	\$ 59.3	\$ 72.2	\$ 76.1	\$ 79.7
Plus (less):									
Gains (losses) on deferred compensation and seed investments	22.1	8.6	10.2	(2.4)	(14.2)	1.7	28.7	1.2	24.4
Transition-related costs	11.6	24.0	15.7	13.7	15.1	42.3	1.9	-	-
Operating income and expenses of consolidated investment vehicles	<u>1.5</u>	<u>0.6</u>	<u>1.4</u>	<u>1.2</u>	<u>0.9</u>	<u>0.9</u>	<u>0.8</u>	<u>0.6</u>	<u>0.9</u>
<b>Operating Income, as Adjusted</b>	<u>\$ 123.1</u>	<u>\$ 130.2</u>	<u>\$ 126.4</u>	<u>\$ 112.9</u>	<u>\$ 108.6</u>	<u>\$ 104.2</u>	<u>\$ 103.7</u>	<u>\$ 77.9</u>	<u>\$ 105.0</u>
Operating Margin, GAAP basis	13.0%	13.4%	13.9%	14.0%	16.0%	9.5%	11.1%	12.1%	12.5%
Operating Margin, as Adjusted	24.1%	24.3%	23.4%	21.0%	21.3%	21.7%	21.2%	16.9%	21.2%

<sup>1</sup> See explanations for Use of Supplemental Data as Non-GAAP Performance Measures in earnings release.

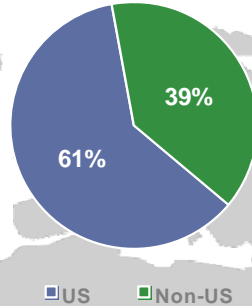
# Appendix - Asset & Revenue Diversity

**Total AUM \$651B**

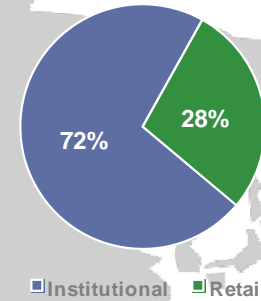
AUM by Asset Class



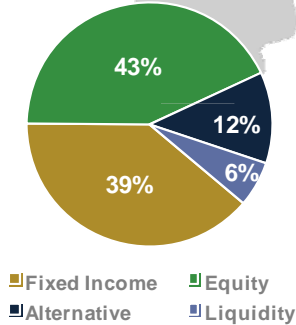
AUM by Client Domicile



AUM by Client



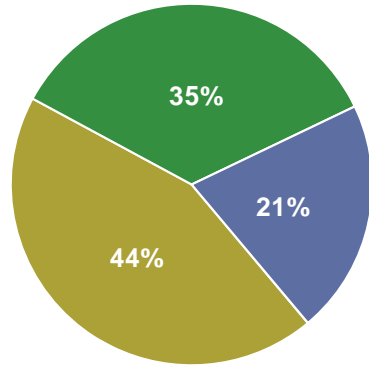
**FYTD 2013 Gross Revenues \$1,271M**



Data as of September 30, 2012

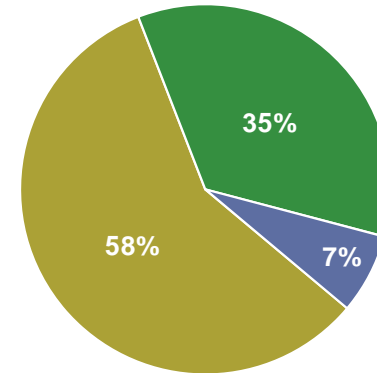
# Appendix - Global Distribution

AUM by Channel



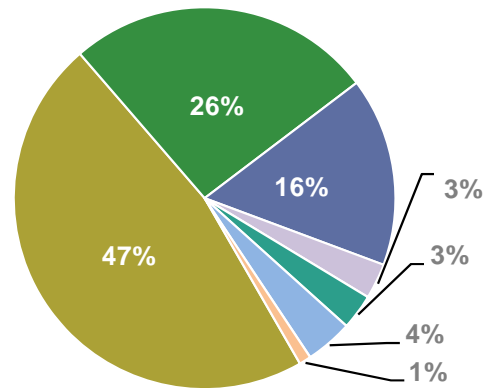
■ US Retail ■ US Individual ■ International

AUM by Product



■ Funds ■ SMA/Sep Accts ■ Closed End

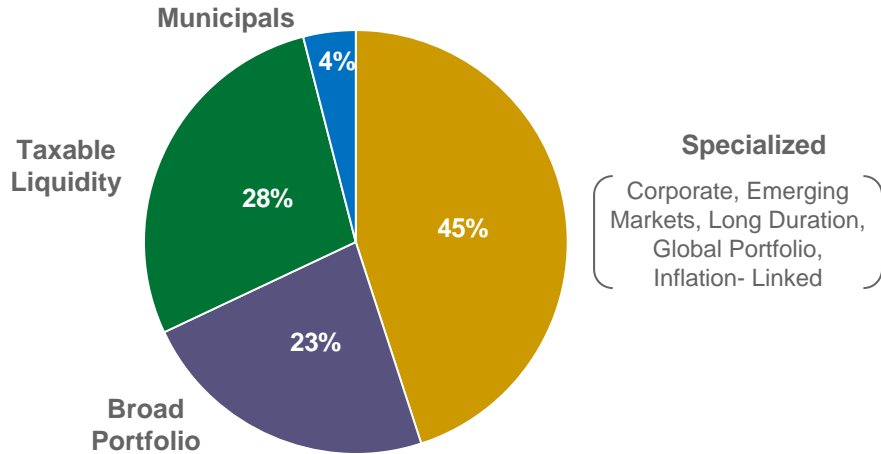
AUM by Affiliate



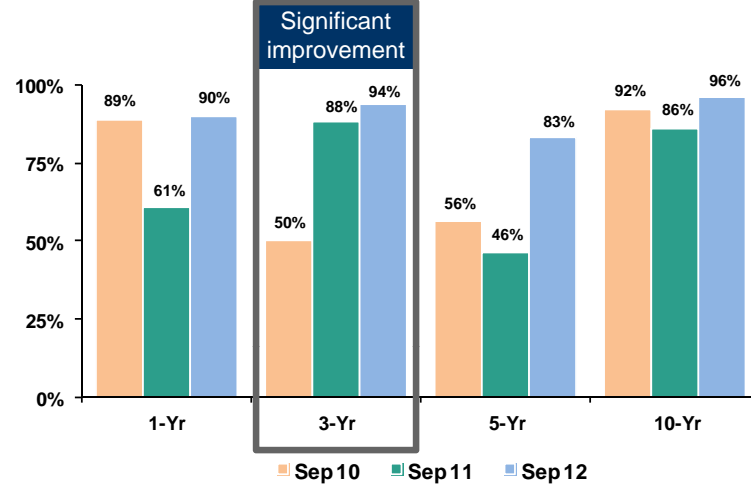
■ WAM ■ CB/GC ■ Royce ■ LMCM  
 ■ BFM ■ BGIM ■ LM Glob Eq

# Appendix - Western Asset Update

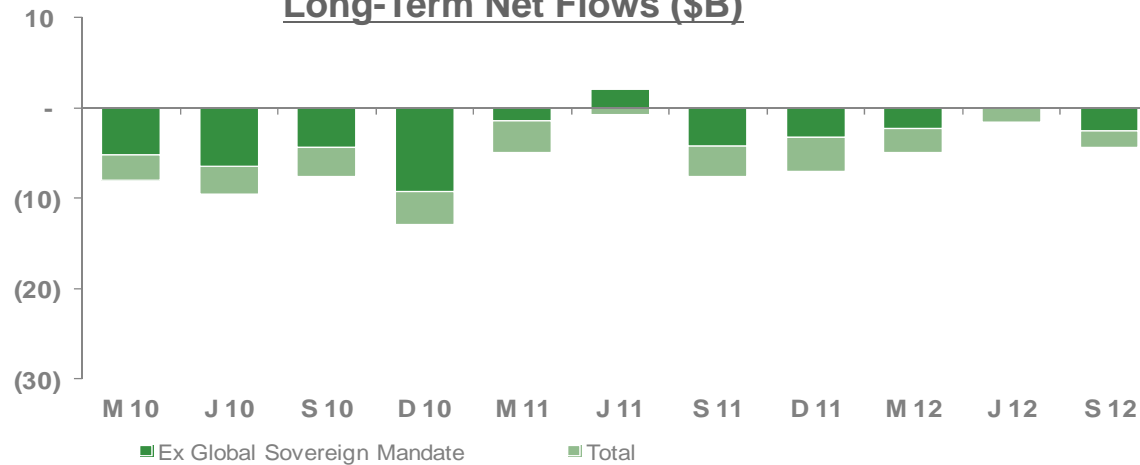
**Total AUM by Mandate: \$459B**



**% of Strategy AUM Beating Benchmark<sup>1</sup>**



**Long-Term Net Flows (\$B)**



<sup>1</sup> Western Asset marketed strategy assets including liquidity



## Appendix – Strategy Performance

For purposes of investment performance comparisons, strategies are an aggregation of discretionary portfolios (separate accounts, investment funds, and other products) into a single group that represents a particular investment objective. In the case of separate accounts, the investment performance of the account is based upon the performance of the strategy to which the account has been assigned. Each of our asset managers has its own specific guidelines for including portfolios in their strategies. For those managers which manage both separate accounts and investment funds in the same strategy, the performance comparison for all of the assets is based upon the performance of the separate account.

Ninety percent of total AUM is included in strategy AUM as of September 30, 2012, although not all strategies have three, five, and ten year histories. Total strategy AUM includes liquidity assets. Certain assets are not included in reported performance comparisons. These include: accounts that are not managed in accordance with the guidelines outlined above; accounts in strategies not marketed to potential clients; accounts that have not yet been assigned to a strategy; and certain smaller products at some of our affiliates.

Past performance is not indicative of future results. For AUM included in institutional and retail separate accounts and investment funds managed in the same strategy as separate accounts, performance comparisons are based on gross-of-fee performance. For investment funds (including fund-of-hedge funds) which are not managed in a separate account format, performance comparisons are based on net-of-fee performance. These performance comparisons do not reflect the actual performance of any specific separate account or investment fund; individual separate account and investment fund performance may differ. The information in this presentation is provided solely for use in connection with this presentation, and is not directed toward existing or potential clients of Legg Mason.

Effective July 1, 2012 our fund-of-hedge funds are compared against relevant hedge fund indexes rather than broad market indexes. Prior periods have been restated to reflect the current presentation.