LEGG MASON, INC.
Form 10-Q
November 06, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q
(Mark One)
[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2014
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.

114,109,608 shares of common stock as of the close of business on October 31, 2014.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	September 30, 2014	March 31, 2014
ASSETS		
Current Assets		
Cash and cash equivalents	$658,974	$858,022
Cash and cash equivalents of consolidated investment vehicles	1,530	56,372
Restricted cash	9,158	13,455
Receivables:		
Investment advisory and related fees	344,394	348,633
Other	57,689	68,186
Investment securities	414,923	467,726
Investment securities of consolidated investment vehicles	49,931	50,463
Deferred income taxes	180,239	186,147
Other	96,258	47,677
Other assets of consolidated investment vehicles	826	31,702
Total Current Assets	1,813,922	2,128,383
Fixed assets, net	182,091	189,241
Intangible assets, net	3,170,628	3,171,773
Goodwill	1,231,335	1,240,523
Investments of consolidated investment vehicles	32,229	31,810
Deferred income taxes	166,843	165,705
Other	157,809	183,706
Other assets of consolidated investment vehicles	175	208
TOTAL ASSETS	$6,755,032	$7,111,349
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Current Liabilities		
Accrued compensation	$261,443	$425,466
Accounts payable and accrued expenses	210,495	214,819
Current portion of long-term debt	219	438
Other	107,399	91,586
Debt and other current liabilities of consolidated investment vehicles	2,425	88,936
Total Current Liabilities	581,981	821,245
Deferred compensation	51,790	49,618
Deferred income taxes	290,461	265,583
Other	147,500	166,209
Long-term debt	1,052,062	1,038,826
TOTAL LIABILITIES	2,123,794	2,341,481

Commitments and Contingencies (Note 9)		
REDEEMABLE NONCONTROLLING INTERESTS	47,449	45,144
STOCKHOLDERS' EQUITY		
Common stock, par value $.10; authorized 500,000,000 shares; issued 114,510,328 shares in September 2014 and 117,173,639 shares in March 2014	11,451	11,717
Additional paid-in capital	2,990,044	3,148,396
Employee stock trust	(31,114)	(29,922)
Deferred compensation employee stock trust	31,114	29,922
Retained earnings	1,565,983	1,526,662
Accumulated other comprehensive income, net	16,311	37,949
TOTAL STOCKHOLDERS' EQUITY	4,583,789	4,724,724
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$6,755,032	$7,111,349

See Notes to Consolidated Financial Statements

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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,	
	2014	2013	2014	2013
OPERATING REVENUES				
Investment advisory fees:				
Separate accounts	$204,739	$191,645	$409,509	$382,679
Funds	389,238	372,679	770,865	743,150
Performance fees	13,993	17,346	30,296	39,367
Distribution and service fees	94,481	86,202	184,197	171,081
Other	1,444	1,980	2,909	3,992
Total Operating Revenues	703,895	669,852	1,397,776	1,340,269
OPERATING EXPENSES				
Compensation and benefits	303,878	294,272	609,384	590,383
Distribution and servicing	155,100	155,142	303,808	325,330
Communications and technology	44,624	39,968	86,574	78,367
Occupancy	22,710	24,922	49,667	51,731
Amortization of intangible assets	464	3,624	1,359	7,248
Other	46,764	45,558	97,083	97,310
Total Operating Expenses	573,540	563,486	1,147,875	1,150,369
OPERATING INCOME	130,355	106,366	249,901	189,900
OTHER NON-OPERATING INCOME (EXPENSE)				
Interest income	1,680	1,371	4,205	3,010
Interest expense	(14,975)	(12,859)	(32,033)	(25,927)
Other income (expense), net, including $107,074 debt extinguishment loss in July 2014	(108,156)	9,662	(101,908)	9,747
Other non-operating income (loss) of consolidated investment vehicles, net	(79)	2,311	2,928	5,008
Total Other Non-Operating Income (Expense)	(121,530)	485	(126,808)	(8,162)
INCOME BEFORE INCOME TAX PROVISION	8,825	106,851	123,093	181,738
Income tax provision	3,804	19,153	44,460	44,945
NET INCOME	5,021	87,698	78,633	136,793
Less: Net income attributable to noncontrolling interests	124	1,410	1,548	2,690
NET INCOME ATTRIBUTABLE TO LEGG MASON, INC.	$4,897	$86,288	$77,085	$134,103
NET INCOME PER SHARE ATTRIBUTABLE TO LEGG MASON, INC. SHAREHOLDERS:				
Basic	$0.04	$0.70	$0.66	$1.08
Diluted	$0.04	$0.70	$0.66	$1.08

WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING				
Basic	115,799	122,974	116,459	124,095
Diluted	116,940	123,207	117,574	124,308
DIVIDENDS DECLARED PER SHARE	$0.16	$0.13	$0.32	$0.26

See Notes to Consolidated Financial Statements

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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,	
	2014	2013	2014	2013
NET INCOME	$5,021	$87,698	$78,633	$136,793
Other comprehensive income (loss):				
Foreign currency translation adjustment	(32,240)	10,350	(21,524)	(15,092)
Unrealized gains (losses) on investment securities:				
Unrealized holding losses, net of tax benefit of $0, $(5), $(3) and $(98), respectively	—	(7)	(5)	(148)
Reclassification adjustment for losses included in net income	—	5	5	11
Net unrealized losses on investment securities	—	(2)	—	(137)
Unrealized gains (losses) on reverse treasury rate lock, net of tax provision (benefit) of $(262) and $233, respectively	(368)	—	405	—
Reclassification for realized gain on termination of reverse treasury rate lock, net of tax provision of $(233)	(405)	—	(405)	—
Reclassification for assets held for sale	—	—	(114)	—
Total other comprehensive income (loss)	(33,013)	10,348	(21,638)	(15,229)
COMPREHENSIVE INCOME (LOSS)	(27,992)	98,046	56,995	121,564
Less: Comprehensive income attributable to noncontrolling interests	124	1,410	1,548	2,690
COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO LEGG MASON, INC.	$(28,116)	$96,636	$55,447	$118,874

See Notes to Consolidated Financial Statements

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

	Six Months Ended September 30, 2014	2013
COMMON STOCK		
Beginning balance	$11,717	$12,534
Stock options and other stock-based compensation	50	47
Deferred compensation employee stock trust	3	4
Deferred compensation, net	98	104
Employee tax withholdings by settlement of net share transactions	(46)	(43)
Shares repurchased and retired	(371)	(532)
Ending balance	11,451	12,114
ADDITIONAL PAID-IN CAPITAL		
Beginning balance	3,148,396	3,449,190
Stock options and other stock-based compensation	17,376	21,815
Deferred compensation employee stock trust	1,707	1,236
Deferred compensation, net	23,601	24,726
Employee tax withholdings by settlement of net share transactions	(21,386)	(13,410)
Shares repurchased and retired	(179,650)	(179,415)
Ending balance	2,990,044	3,304,142
EMPLOYEE STOCK TRUST		
Beginning balance	(29,922)	(32,623)
Shares issued to plans	(1,710)	(1,240)
Distributions and forfeitures	518	3,442
Ending balance	(31,114)	(30,421)
DEFERRED COMPENSATION EMPLOYEE STOCK TRUST		
Beginning balance	29,922	32,623
Shares issued to plans	1,710	1,240
Distributions and forfeitures	(518)	(3,442)
Ending balance	31,114	30,421
RETAINED EARNINGS		
Beginning balance	1,526,662	1,304,259
Net Income Attributable to Legg Mason, Inc.	77,085	134,103
Dividends declared	(37,764)	(32,279)
Ending balance	1,565,983	1,406,083
APPROPRIATED RETAINED EARNINGS FOR CONSOLIDATED INVESTMENT VEHICLE		
Beginning balance	—	4,829
Net income reclassified to appropriated retained earnings	—	1,792
Ending balance	—	6,621
ACCUMULATED OTHER COMPREHENSIVE INCOME, NET		
Beginning balance	37,949	47,539
Net unrealized losses on investment securities	—	(137)
Reclassification for assets held for sale	(114)	—
Foreign currency translation adjustment	(21,524)	(15,092)
Ending balance	16,311	32,310

TOTAL STOCKHOLDERS’ EQUITY	$4,583,789	$4,761,270

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, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$78,633	$136,793
5.5% Senior Notes Due 2019:		
Loss on extinguishment	107,074	—
Allocation of repurchase payment	(98,418)	—
Adjustments to reconcile Net Income to net cash provided by operations:		
Depreciation and amortization	27,985	31,271
Accretion and amortization of securities discounts and premiums, net	545	1,520
Stock-based compensation	34,700	32,958
Net gains on investments	(2,149)	(7,790)
Net gains of consolidated investment vehicles	(2,124)	(4,128)
Deferred income taxes	4,639	38,385
Other	(1,252)	4,589
Decrease (increase) in assets:		
Investment advisory and related fees receivable	1,997	3,741
Net sales (purchases) of trading and other current investments	71,301	(38,590)
Other receivables	(5,720)	(7,554)
Other assets	14,524	(11,301)
Other assets of consolidated investment vehicles	87,989	36,942
Increase (decrease) in liabilities:		
Accrued compensation	(157,657)	(82,371)
Deferred compensation	2,172	(4,784)
Accounts payable and accrued expenses	(5,797)	(11,094)
Other liabilities	(19,489)	(8,074)
Other liabilities of consolidated investment vehicles	(7,332)	(10,296)
CASH PROVIDED BY OPERATING ACTIVITIES	131,621	100,217
CASH FLOWS FROM INVESTING ACTIVITIES		
Payments for fixed assets	(20,604)	(20,280)
Proceeds from sale of assets	—	1,351
Business acquisition, net of cash acquired	(10,558)	—
Change in restricted cash	2,988	(5,217)
Purchases of investment securities	(2,641)	(1,081)
Proceeds from sales and maturities of investment securities	2,688	1,361
Purchases of investments by consolidated investment vehicles	—	(14,440)
Proceeds from sales and maturities of investments by consolidated investment vehicles	—	95,141
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	$(28,127)	$56,835

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

	Six Months Ended September 30, 2014	2013
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayment of long-term debt	$(645,561)	$(50,220)
Repayment of long-term debt of consolidated investment vehicles	(79,179)	(103,329)
Proceeds from issuance of long-term debt	658,769	—
Debt issuance costs	(4,529)	—
Issuance of common stock for stock-based compensation	15,883	13,002
Employee tax withholdings by settlement of net share transactions	(21,432)	(13,453)
Repurchase of common stock	(180,021)	(179,947)
Dividends paid	(34,759)	(30,430)
Net (redemptions/distributions paid to)/subscriptions received from noncontrolling interest holders	757	(3,164)
CASH USED IN FINANCING ACTIVITIES	(290,072)	(367,541)
EFFECT OF EXCHANGE RATES ON CASH	(12,470)	(10,691)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(199,048)	(221,180)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	858,022	933,036
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$658,974	$711,856

See Notes to Consolidated Financial Statements

LEGG MASON, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in thousands, except per share amounts or unless otherwise noted)
September 30, 2014
(Unaudited)

1. Interim Basis of Reporting

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

The nature of Legg Mason's business is such that the results of any interim period are not necessarily indicative of the results of a full year. Certain disclosures included in the Company's annual report are not required to be included on an interim basis in the Company's quarterly reports on Forms 10-Q. The Company has condensed or omitted these disclosures. Certain less significant 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 vehicles. 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 assets to any of these investment vehicles. In accordance with financial accounting standards, Legg Mason consolidates certain sponsored investment vehicles, some of which are designated as consolidated investment vehicles (“CIVs”). The consolidation of investment vehicles 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 these CIVs, which is recorded in Other Non-Operating Income (Expense), is reflected in Net Income, net of amounts allocated to noncontrolling interests.

Certain investment vehicles Legg Mason sponsors and is the manager of are considered to be variable interest entities ("VIEs") (further described below) while others are considered to be voting rights entities (“VREs”) subject to traditional consolidation concepts based on ownership rights. Investment vehicles that are considered VREs are consolidated if Legg Mason has a controlling financial interest in the investment vehicle, absent substantive investor rights to replace the manager of the entity (kick-out rights). Legg Mason may also fund the initial cash investment in certain VRE investment vehicles 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. Legg Mason held a longer-term controlling financial interest in one sponsored investment fund VRE, which has third-party investors and was consolidated and included as a CIV as of September 30, 2014, March 31, 2014, and September 30, 2013.

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 for a potential controlling financial interest.

Investment Company VIEs

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

Legg Mason concluded it was the primary beneficiary of one sponsored investment fund VIE, which was consolidated (and designated a CIV) as of September 30, 2014, March 31, 2014 and September 30, 2013, despite significant third party investments in this product. As of September 30, 2014 and March 31, 2014, Legg Mason also concluded it was the primary beneficiary of 16 employee-owned funds it sponsors, which were consolidated and reported as CIVs.

Other VIEs

For other sponsored investment funds that do not meet the investment company criteria, Legg Mason determines it is the primary beneficiary of a VIE if it has both the power to direct the activities of a VIE that most significantly impact the entity's economic performance and the obligation to absorb losses, or the right to receive benefits, that potentially could be significant to a VIE.

As of September 30, 2014, 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 holds no equity interest in these investment vehicles and their level of expected fees is insignificant. As of March 31, 2014 and September 30, 2013, Legg Mason had a variable interest in two of these CLOs, which also were not consolidated in either of these periods.

As of March 31, 2014 and September 30, 2013, Legg Mason concluded that it was the primary beneficiary of another CLO in which it held a variable interest. Although it held no equity interest in this investment vehicle, it had both the power to control and had a significant variable interest because of the level of its expected subordinated fees. As of March 31, 2014 and September 30, 2013, the balances related to this CLO were consolidated and reported as a CIV in the Company's consolidated financial statements. During the three months ended June 30, 2014, this CLO was substantially liquidated and therefore was not consolidated by Legg Mason as of September 30, 2014.

See Notes 4 and 12 for additional information regarding VIEs and VREs.

Noncontrolling Interests

For CIVs with third-party investors, the related noncontrolling interests are classified as redeemable noncontrolling interests if investors in these funds may request withdrawals at any time. Also included in redeemable noncontrolling interests are vested affiliate management equity plan interests. There were no nonredeemable noncontrolling interests as of September 30, 2014 or March 31, 2014. Net income attributable to noncontrolling interests in the Consolidated Statements of Income for the three and six months ended September 30, 2013 also includes Net income reclassified to appropriated retained earnings for consolidated investment vehicle in the Consolidated Balance Sheet as of September 30, 2013.

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Net income attributable to noncontrolling interests for the three and six months ended September 30, included the following amounts:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Net income attributable to redeemable noncontrolling interests	$124	$17	$1,548	$898
Net income reclassified to appropriated retained earnings for consolidated investment vehicle	—	1,393	—	1,792
Total	$124	$1,410	$1,548	$2,690

Redeemable noncontrolling interests as of and for the six months ended September 30, included the following amounts:

	Six Months Ended September 30,	
	2014	2013
Balance, beginning of period	$45,144	$21,009
Net income attributable to redeemable noncontrolling interests	1,548	898
Net (redemptions/distributions paid to)/subscriptions received from noncontrolling interest holders	757	(3,164)
Balance, end of period	$47,449	$18,743

Accumulated Other Comprehensive Income

There were no significant amounts reclassified from Accumulated other comprehensive income to the Consolidated Statements of Income for the three or six months ended September 30, 2014 or 2013, except for $638 realized on the termination of a reverse treasury rate lock contract, as further described in Note 7.

Recent Accounting Developments

In May 2014, the Financial Accounting Standards Board (“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. This update will be effective for Legg Mason in fiscal 2018 and Legg Mason is evaluating the impact of its adoption.

In August 2014, the FASB updated the guidance on measuring the financial assets and financial liabilities of consolidated collateralized financing entities. The update requires that an entity electing to apply the guidance should measure both the financial assets and financial liabilities using the fair value of the consolidated collateralized financing entity’s financial assets or financial liabilities, whichever is more observable. This update also requires certain disclosures by entities that apply its provisions and will be effective for Legg Mason in fiscal 2017, unless adopted earlier. Legg Mason is evaluating the impact of its adoption.

3. Acquisitions and Disposition

QS Investors, LLC

Effective May 31, 2014, Legg Mason acquired all of the outstanding equity interests of QS Investors, LLC ("QS Investors"), a customized solutions and global quantitative equities provider, in accordance with a Purchase Agreement entered into in March 2014. At the time of acquisition, QS Investors had approximately $5,000,000 in assets under management ("AUM") and nearly $100,000,000 in assets under advisement.

The initial purchase price was a cash payment of $11,000, funded from existing cash. In addition, contingent consideration of up to $10,000 and $20,000 for the second and fourth anniversary payments may be due in July 2016 and July 2018, respectively, dependent on the achievement of certain net revenue targets, and subject to a potential catch-up adjustment in the fourth anniversary payment for any second anniversary payment shortfall. The contingent consideration liability established at closing had an acquisition date fair value of $13,370, which represented the present value of the contingent consideration expected to be paid. The contingent consideration liability is included in Other liabilities in the Consolidated Balance Sheet at September 30, 2014 and has accreted to $13,453.

A summary of the acquisition-date fair values of the assets acquired and liabilities assumed, after certain measurement period adjustments, are as follows:

Consideration	
Cash	$11,000
Contingent consideration	13,370
Total Consideration	24,370
Identifiable assets and liabilities	
Cash	441
Investments	3,281
Receivables	2,699
Amortizable asset management contracts	7,060
Fixed assets	599
Liabilities, net	(6,620)
Total identifiable assets and liabilities	7,460
Goodwill	$16,910

The fair value of the amortizable asset management contracts is being amortized over a period of 10 years. Purchase price allocated to goodwill is expected to be deductible for U.S. tax purposes over a period of 15 years.

Management estimated the fair values of the amortizable asset management contracts based upon discounted cash flow analyses, and the contingent consideration expected to be paid and discounted, based upon probability-weighted revenue projections, using unobservable market data inputs, which are Level 3 measurements. The significant assumptions used in these analyses at acquisition including projected annual cash flows, revenues and discount rates, are summarized as follows:

	Projected Cash Flow Attrition	Discount Rate
Amortizable asset management contracts	(10)%	15.0%

	Projected Revenue Growth Rates	Discount Rates
Contingent consideration	0% to 10% (weighted-average - 6%)	1.2% / 2.1%

Goodwill is principally attributable to synergies expected to arise with the integration of QS Investors.

The Company has not presented pro forma combined results of operations for this acquisition because the results of operations as reported in the accompanying Consolidated Statements of Income would not have been materially different. The financial results of QS Investors included in Legg Mason's consolidated financial results for the three and six months ended September 30, 2014 were not significant.

Over time, Legg Mason plans to integrate two existing affiliates, QS Batterymarch Financial Management, Inc. ("Batterymarch") and QS Legg Mason Global Asset Allocation, LLC ("LMGAA"), into QS Investors to capture synergies and leverage the best capabilities of each entity. In connection with the integration, Legg Mason expects to incur cumulative restructuring and transition costs up to approximately $40,000, primarily comprised of charges for employee termination benefits, including severance and retention incentives, as well as real estate related charges. Total charges for restructuring and transition costs of $24,140 have been recognized through September 30, 2014, which includes $7,946 and $21,582 for the three and six months, respectively, ended September 30, 2014, primarily recorded in Compensation and benefits in the Consolidated Statements of Income.

The table below presents a summary of changes in the restructuring and transition-related liability from March 31, 2013 through September 30, 2014 and cumulative charges incurred to date:

	Compensation	Other	Total
Balance as of December 31, 2013	$—	$—	$—
Accrued charges	2,161	111	2,272
Balance as of March 31, 2014	2,161	111	2,272
Accrued charges	18,828	596	19,424
Payments	(9,936)	(384)	(10,320)
Balance as of September 30, 2014	$11,053	$323	$11,376
Non-cash charges(1)			
Year ended March 31, 2014	$—	$286	$286
Six Months Ended September 30, 2014	588	1,570	2,158
Total	$588	$1,856	$2,444
Cumulative charges incurred as of September 30, 2014	$21,577	$2,563	$24,140

(1) Includes stock-based compensation expense and accelerated fixed asset depreciation.

Legg Mason expects to incur up to approximately $16,000 in additional restructuring and transition costs associated with the integration of Batterymarch and LMGAA into QS Investors, with up to approximately $13,000 of the anticipated remaining costs expected to be incurred in the remainder of fiscal 2015.

Fauchier Partners Management, Limited

On March 13, 2013, The Permal Group Ltd. ("Permal"), a wholly-owned subsidiary of Legg Mason, completed the acquisition of all of the outstanding share capital of Fauchier Partners Management, Limited ("Fauchier"), a European based manager of funds-of-hedge funds, from BNP Paribas Investment Partners, S.A. in accordance with a Sale and Purchase Agreement entered into in December 2012.

As of September 30, 2014, the fair value of the contingent consideration liability was $29,200, a decrease of $353 from March 31, 2014, all of which is attributable to changes in the exchange rate, net of accretion. The contingent consideration liability is included in Other current liabilities and Other non-current liabilities in the Consolidated Balance Sheets. Legg Mason has executed currency forwards to economically hedge the risk of movements in the exchange rate between the U.S. dollar and the British pound in which the estimated contingent liability payment amounts are denominated. See Note 11 for additional information regarding derivatives and hedging.

Legg Mason Investment Counsel & Trust

On June 4, 2014, Legg Mason announced an agreement to sell all of its equity interests in Legg Mason Investment Counsel & Trust Company N.A. (subsequently renamed 1919 Investment Counsel & Trust) ("LMIC") to Stifel Financial Corporation's Global Wealth Management segment. The sale is expected to be completed in November 2014.

Related assets and liabilities held for sale of $47,263 and $8,713, respectively, were included in Other current assets and Other current liabilities, respectively, in the Consolidated Balance Sheet at September 30, 2014. These assets included $11,994 of available-for-sale investments with related net unrealized gains of $114, previously included in Accumulated other comprehensive income, net, at March 31, 2014. The sale is not expected to have a material impact on Legg Mason's consolidated financial condition or results of operations.

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4. Investments and Fair Value of Assets and Liabilities

The disclosures below include details of Legg Mason's assets and liabilities that are measured at fair value, excluding the assets and liabilities of CIVs. See Note 12, Variable Interest Entities and Consolidation of Investment Vehicles, for information related to the assets and liabilities of CIVs that are measured at fair value.

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

	As of September 30, 2014			
	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets:				
Cash equivalents(1):				
Money market funds	$227,856	$—	$—	$227,856
Time deposits and other	—	58,561	—	58,561
Total cash equivalents	227,856	58,561	—	286,417
Current investments:				
Trading investments relating to long-term incentive compensation plans(2)	78,715	—	—	78,715
Trading investments of proprietary fund products and other trading investments(3)	233,544	85,264	170	318,978
Equity method investments relating to long-term incentive compensation plans, proprietary fund products and other investments(4)(5)	8,544	8,686	—	17,230
Total current investments	320,803	93,950	170	414,923
Investments in partnerships, LLCs and other(6)	—	—	17,682	17,682
Equity method investments in partnerships and LLCs(4)(6)	`—	—	55,857	55,857
Derivative assets(7)	5,243	—	—	5,243
Other investments(6)	—	—	85	85
Total	$553,902	$152,511	$73,794	$780,207
Liabilities:				
Long-term debt(8)	$—	$(249,451)	$—	$(249,451)
Contingent consideration liabilities(9)	—	—	(42,653)	(42,653)
Derivative liabilities(7)	(4,669)	(549)	—	(5,218)
Total	$(4,669)	$(250,000)	$(42,653)	$(297,322)

	As of March 31, 2014			
	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets:				
Cash equivalents[1]:				
Money market funds	$456,631	$—	$—	$456,631
Time deposits and other	—	106,226	—	106,226
Total cash equivalents	456,631	106,226	—	562,857
Current investments:				
Trading investments relating to long-term incentive compensation plans[2]	109,648	—	—	109,648
Trading investments of proprietary fund products and other trading investments[3]	260,251	75,015	190	335,456
Equity method investments relating to long-term incentive compensation plans, proprietary fund products and other investments[4][5]	8,497	14,125	—	22,622
Total current investments	378,396	89,140	190	467,726
Available-for-sale investment securities[6]	2,048	10,024	—	12,072
Investments in partnerships, LLCs and other[6]	—	2,878	21,586	24,464
Equity method investments in partnerships and LLCs[4][6]	—	—	62,973	62,973
Derivative assets[7]	3,584	—	—	3,584
Other investments[6]	—	—	90	90
Total	$840,659	$208,268	$84,839	$1,133,766
Liabilities:				
Contingent consideration liability[9]	$—	$—	$(29,553)	$(29,553)
Derivative liabilities[7]	(2,335)	—	—	(2,335)
Total	$(2,335)	$—	$(29,553)	$(31,888)

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

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

(3) Trading investments of proprietary fund products and other trading investments consist of approximately 57% and 43% in equity and debt securities, respectively, as of September 30, 2014, and approximately 53% and 47% in equity and debt securities, respectively, as of March 31, 2014.

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

(5) Includes investments under the equity method (which approximate fair value) relating to long-term incentive compensation plans of $8,686 and $14,125 as of September 30, 2014 and March 31, 2014, respectively, and proprietary fund products and other investments of $8,544 and $8,497 as of September 30, 2014 and March 31, 2014, respectively, which are classified as Investment securities in the Consolidated Balance Sheets.

(6)

Amounts are included in Other non-current assets in the Consolidated Balance Sheets for each of the periods presented.

(7) See Note 11.

(8) See Note 7.

(9) See Note 3.

Proprietary fund products include seed capital investments made by Legg Mason to fund new investment strategies and products. Legg Mason had investments in proprietary fund products, which totaled $382,288 and $405,918, as of September 30, 2014 and March 31, 2014, respectively, which are substantially comprised of investments in 47 funds and 46 funds,

respectively, that are individually greater than $1,000, with minimal third party investment, and together comprise over 90% of the seed capital investments total in each period.
See Notes 2 and 12 for information regarding the determination of whether investments in proprietary fund products represent VIEs.
Substantially all of the above financial instruments where valuation methods rely on other than observable market inputs as a significant input utilize the equity method, the cost method, or NAV practical expedient discussed below, such that measurement uncertainty has little relevance.
The changes in financial assets and (liabilities) measured at fair value using significant unobservable inputs (Level 3) for the three and six months ended September 30, 2014 and 2013, are presented in the tables below:

	Value as of June 30, 2014	Purchases	Sales	Redemptions/ Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of September 30, 2014
Assets:							
Trading investments of proprietary fund products and other trading investments	$179	$—	$(9)	$—	$—	$ —	$170
Investments in partnerships, LLCs and other	21,654	—	(24)	(3,443)	—	(505)	17,682
Equity method investments in partnerships and LLCs	57,621	78	(990)	(363)	—	(489)	55,857
Other investments	92	—	—	—	—	(7)	85
	$79,546	$78	$(1,023)	$(3,806)	$—	$ (1,001)	$73,794
Liabilities:							
Contingent consideration liabilities	$(43,984)	$—	$—	$—	$—	$ 1,331	$(42,653)

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	Value as of June 30, 2013	Purchases	Sales	Redemptions/Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of September 30, 2013
Assets:							
Trading investments of proprietary fund products and other trading investments	$233	$—	$—	$ (31)	$—	$ 7	$209
Investments in partnerships, LLCs and other	28,018	—	(424)	1	—	(406)	27,189
Equity method investments in partnerships and LLCs	63,353	2,570	(437)	(2,116)	—	269	63,639
Other investments	105	—	—	—	—	2	107
	$91,709	$2,570	$(861)	$ (2,146)	$—	$ (128)	$91,144
Liabilities:							
Contingent consideration liability	$(21,931)	$—	$—	$ —	$—	$ (1,404)	$(23,335)

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	Value as of March 31, 2014	Purchases	Sales	Redemptions/ Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of September 30, 2014
Assets:							
Trading investments of proprietary fund products and other trading investments	$190	$—	$(19)	$—	$—	$(1)	$170
Investments in partnerships, LLCs and other	21,586	—	(24)	(3,443)	—	(437)	17,682
Equity method investments in partnerships and LLCs	62,973	1,046	(6,838)	(927)	—	(397)	55,857
Other investments	90	—	—	—	—	(5)	85
	$84,839	$1,046	$(6,881)	$(4,370)	$—	$(840)	$73,794
Liabilities:							
Contingent consideration liabilities	$(29,553)	$(13,370)	$—	$—	$—	$270	$(42,653)

	Value as of March 31, 2013	Purchases	Sales	Redemptions/Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of September 30, 2013
Assets:							
Trading investments of proprietary fund products and other trading investments	$246	$—	$—	$ (44)	$—	$7	$209
Investments in partnerships, LLCs and other	27,762	800	(617)	(164)	—	(592)	27,189
Equity method investments in partnerships and LLCs	66,338	2,766	(750)	(5,688)	—	973	63,639
Other investments	111	—	—	—	—	(4)	107
	$94,457	$3,566	$(1,367)	$ (5,896)	$—	$384	$91,144
Liabilities:							
Contingent consideration liability	$(21,900)	$—	$—	$ —	$—	$(1,435)	$(23,335)

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Realized and unrealized gains and losses recorded for Level 3 investments are primarily included in Other Non-Operating Income (Expense) in the Consolidated Statements of Income. The change in unrealized gains (losses) for Level 3 investments and liabilities still held at the reporting date was $131 and $(2,397) for the three months ended September 30, 2014 and 2013, respectively. The change in unrealized losses for Level 3 investments and liabilities still held at the reporting date was $1,200 and $3,190 for the six months ended September 30, 2014 and 2013, respectively.

There were no transfers between Level 1 and Level 2 during the three or six months ended September 30, 2014 and 2013.

As a practical expedient, Legg Mason relies on the NAV of certain investments as their fair value. The NAVs that have been provided by the investees have been derived from the fair values of the underlying investments as of the respective reporting dates. The following table summarizes, as of September 30, 2014 and March 31, 2014, the nature of these investments and any related liquidation restrictions or other factors which may impact the ultimate value realized:

		Fair Value Determined Using NAV				As of September 30, 2014	
Category of Investment	Investment Strategy	September 30, 2014		March 31, 2014		Unfunded Commitments	Remaining Term
Funds-of-hedge funds	Global macro, fixed income, long/short equity, natural resources, systematic, emerging market, European hedge	$29,855	(1)	$34,771	(1)	n/a	n/a
Hedge funds	Fixed income - developed market, event driven, fixed income - hedge, relative value arbitrage, European hedge	17,379		19,461		$20,000	n/a
Private equity funds	Long/short equity	22,158	(2)	22,759	(2)	5,184	Up to 8 years
Other	Various	1,919		2,434		n/a	Various (3)
Total		$71,311	(4)	$79,425	(4)	$25,184	

n/a-not applicable

(1) Liquidation restrictions: 29% monthly redemption and 71% quarterly redemption as of September 30, 2014. 40% monthly redemption and 60% quarterly redemption as of March 31, 2014.

(2) Liquidations are expected over the remaining term.

(3) Of this balance, 12% has a remaining term of less than one year and 88% has a remaining term of 19 years.

(4) Comprised of 35% and 65% of Level 2 and Level 3 assets, respectively, as of September 30, 2014 and 31% and 69% of Level 2 and Level 3 assets, respectively, as of March 31, 2014.

There are no current plans to sell any of these investments held as of September 30, 2014.

5. Fixed Assets

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

	September 30, 2014	March 31, 2014

Equipment	$148,754	$147,663
Software	260,387	249,368
Leasehold improvements	208,812	209,747
Total cost	617,953	606,778
Less: accumulated depreciation and amortization	(435,862)	(417,537)
Fixed assets, net	$182,091	$189,241

Depreciation and amortization expense related to fixed assets was $13,551 and $12,176 for the three months ended September 30, 2014 and 2013, respectively, and $26,625 and $24,023 for the six months ended September 30, 2014 and 2013, respectively.

6. Intangible Assets and Goodwill

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

	September 30, 2014	March 31, 2014
Amortizable asset management contracts		
Cost	$176,707	$207,224
Accumulated amortization	(167,697)	(197,255)
Net	9,010	9,969
Indefinite–life intangible assets		
U.S. domestic mutual fund management contracts	2,106,351	2,106,351
Permal/Fauchier funds-of-hedge fund management contracts	698,104	698,104
Other fund management contracts	304,363	304,549
Trade names	52,800	52,800
	3,161,618	3,161,804
Intangible assets, net	$3,170,628	$3,171,773

In connection with the previously discussed agreement to sell LMIC, amortizable asset management contracts with a cost of $36,864 and accumulated amortization of $30,205 were reclassified to assets held for sale. Also, the May 31, 2014 acquisition of QS Investors included amortizable asset management contracts of $7,060. See Note 3 for additional information.

As of Legg Mason's most recent annual impairment test as of December 31, 2013, the assessed fair value of the indefinite-life domestic mutual funds contracts asset related to the Citigroup Asset Management ("CAM") acquisition exceeded the carrying value by approximately 21%; and the assessed fair value of the indefinite-life funds-of-hedge funds contracts asset related to the Permal and Fauchier acquisitions exceeded the combined carrying values by approximately 10%. Should market performance, flows, or related AUM levels decrease in the near term such that cash flow projections deviate from current projections, it is reasonably possible that the assets could be deemed to be impaired by a material amount.

As of September 30, 2014, amortizable asset management contracts are being amortized over a weighted-average remaining life of 8.4 years.

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

Remaining 2015	$553
2016	1,188
2017	1,188
2018	1,188
2019	1,188
Thereafter	3,705
Total	$9,010

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

	Gross Book Value	Accumulated Impairment	Net Book Value
Balance as of March 31, 2014	$2,402,423	$(1,161,900)	$1,240,523
Impact of excess tax basis amortization	(10,858)	—	(10,858)
Business acquisition, net of $8,104 reclassification relating to LMIC (See Note 3)	8,806	—	8,806
Other, including changes in foreign exchange rates	(7,136)	—	(7,136)
Balance as of September 30, 2014	$2,393,235	$(1,161,900)	$1,231,335

7. Long-Term Debt

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

Long-term debt consists of the following:

	September 30, 2014				March 31, 2014
	Current Value	Fair Value Hedge Adjustment	Unamortized Discount (Premium)	Maturity Amount	Accreted Value
2.7% Senior Notes due 2019	$248,927	$549	$524	$250,000	$—
5.5% Senior Notes due 2019	—	—	—	—	645,042
3.95% Senior Notes due 2024	249,555	—	445	250,000	—
5.625% Senior Notes due 2044	553,580	—	(3,580)	550,000	393,784
Other term loans	219	—	—	219	438
Subtotal	1,052,281	549	(2,611)	1,050,219	1,039,264
Less: current portion	219	—	—	219	438
Total	$1,052,062	$549	$(2,611)	$1,050,000	$1,038,826

In June 2014, Legg Mason issued $250,000 of 2.7% Senior Notes due 2019 (the "2019 Notes"), $250,000 of 3.95% Senior Notes due 2024 (the "2024 Notes"), and an additional $150,000 of the existing 5.625% Senior Notes due 2044 (the "2044 Notes" and, together with the 2019 Notes and the 2024 Notes, the "Notes"). In July 2014, the Company used $658,769 in proceeds from the sale of the Notes, together with cash on hand, to call the outstanding $650,000 of 5.5% Senior Notes due 2019 (the "5.5% Senior Notes") and pay a related make-whole premium of $98,418 discussed below.

On June 23, 2014, Legg Mason entered into a reverse treasury rate lock contract with a financial intermediary, which was designated as a cash flow hedge. The contract was issued in connection with the retirement of the 5.5% Senior Notes. The Company entered into the reverse treasury rate lock agreement in order to hedge the variability in the retirement payment on the entire principal amount of debt. The reverse treasury rate lock contract effectively fixed the present value of the forecasted debt make-whole payment which was priced on July 18, 2014, to eliminate risk associated with changes in the five-year U.S. treasury yield.

The 5.5% Senior Notes were retired on July 23, 2014, and resulted in a pre-tax, non-operating charge of $107,074 , consisting of a make-whole premium of $98,418 to call the 5.5% Senior Notes, net of $638 from the settlement of the reverse treasury lock before related administrative fees, and $8,656 associated with existing deferred charges and original issue discount.

2.7% Senior Notes due 2019
The $250,000 2019 Notes were sold at a discount of $553, which is being amortized to interest expense over the five-year term. The 2019 Notes can be redeemed at any time prior to the scheduled maturity in part or in aggregate, at the greater of

the related principal amount at that time or the sum of the remaining scheduled payments discounted at the treasury rate (as defined) plus 0.20%, together with any related accrued and unpaid interest.

On June 23, 2014, Legg Mason entered into an interest rate swap contract with a financial intermediary with a notional amount of $250,000, which was designated as a fair value hedge. The interest rate swap is being used to effectively convert the 2019 Notes from fixed rate debt to floating rate debt and has identical terms as the underlying debt being hedged, so no ineffectiveness is expected. The swap has a five-year term, and matures on July 15, 2019. The fair value of the contract at September 30, 2014, was a derivative liability of $549, which is classified as Other liabilities with a corresponding fair value adjustment to the related carrying value of the debt in the Consolidated Balance Sheet. The swap payment dates coincide with the debt payment dates on July 15 and January 15. The related receipts/payments by Legg Mason are recorded as Interest expense in the Consolidated Statement of Income. Cash collateral of $2,000 was provided for the interest rate swap as of September 30, 2014. Since the terms and conditions of the hedged instruments are unchanged, the swap continues to be an effective fair value hedge.

3.95% Senior Notes due 2024
The $250,000 2024 Notes were sold at a discount of $458, which is being amortized to interest expense over the 10-year term. The 2024 Notes can be redeemed at any time prior to the scheduled maturity in part or in aggregate, at the greater of the related principal amount at that time or the sum of the remaining scheduled payments discounted at the treasury rate (as defined) plus 0.25%, together with any related accrued and unpaid interest.

5.625% Senior Notes due 2044
The $150,000 additional 2044 Notes were sold at a premium of $9,779, which is being amortized to interest expense over the 30-year term. The 2044 Notes can be redeemed at any time prior to the scheduled maturity in part or in aggregate, at the greater of the related principal amount at that time or the sum of the remaining scheduled payments discounted at the treasury rate (as defined) plus 0.30%, together with any related accrued and unpaid interest.

As of September 30, 2014, the aggregate maturities of long-term debt by fiscal year, based on their contractual terms, are as follows:

Remaining 2015	$219
2016	—
2017	—
2018	—
2019	—
Thereafter	1,050,000
Total	$1,050,219

At September 30, 2014, the estimated fair value of long-term debt was approximately $1,102,771, including $249,451 for the 2019 Notes which are carried at fair value in the Consolidated Balance Sheet. The debt fair value was estimated using publicly quoted market prices and was classified as Level 2 in the fair value hierarchy.

8. Stock-Based Compensation

Legg Mason's stock-based compensation includes stock options, an employee stock purchase plan, market-based performance shares payable in common stock, restricted stock awards and units, management equity plans and deferred compensation payable in stock. Shares available for issuance under the active equity incentive stock plan as of September 30, 2014, were 8,184. Options under Legg Mason’s employee stock plans have been granted at prices not less than 100% of the fair market value. Options are generally exercisable in equal increments over four or five years and expire within eight to ten years from the date of grant.

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Stock Options

Compensation expense relating to stock options for the three months ended September 30, 2014, and 2013 was $2,953 and $3,746, respectively, and for the six months ended September 30, 2014, and 2013 was $6,217 and $6,987, respectively.

Stock option transactions under Legg Mason's equity incentive plans during the six months ended September 30, 2014, and 2013 are summarized below:

	Six Months Ended September 30,			
	2014		2013	
	Number of Shares	Weighted-Average Exercise Price Per Share	Number of Shares	Weighted-Average Exercise Price Per Share
Options Outstanding at March 31	4,801	$43.02	5,361	$53.13
Granted	916	47.64	1,215	33.64
Exercised	(453)	30.76	(405)	29.64

$ 91.15

Morgan Stanley noted that the illustrative future and present value share price analysis was presented for reference purposes only and is not predictive of actual future trading levels.

General

In connection with the review of the merger agreement and the transactions contemplated thereby by the Capella board of directors, Morgan Stanley performed a variety of financial and comparative analyses for purposes of rendering its opinion. The preparation of a financial opinion is a complex process and is not necessarily susceptible to a partial analysis or summary description. In arriving at its opinion, Morgan Stanley considered the results of all of its analyses as a whole and did not attribute any particular weight to any analysis or factor it considered. Morgan Stanley believes that selecting any portion of its analyses, without considering all analyses as a whole, would create an incomplete view of the process underlying its analyses and opinion. In addition, Morgan Stanley may have given various analyses and factors more or less weight than other analyses and factors, and may have deemed various assumptions more or less probable than other assumptions. As a result, the ranges of valuations resulting from any particular analysis described above should not be taken to be Morgan Stanley's view of the actual value of Strayer or Capella. In performing its analyses, Morgan Stanley made numerous assumptions with regard to industry performance, general business, economic, market and financial conditions and other matters, many of which are beyond the control of Strayer or Capella. These include, among other things, the impact of competition on Strayer's and Capella's businesses and the industry generally, industry growth, and the absence of any adverse material change in the financial condition and prospects of Strayer or Capella, or the industry, or in the financial markets in general. Any estimates contained in Morgan Stanley's analyses are not necessarily indicative of future results or actual values, which may be significantly more or less favorable than those suggested by such estimates.

Morgan Stanley conducted the analyses described above solely as part of its analysis of whether the merger exchange ratio pursuant to the merger agreement was fair from a financial point of view to the holders of shares of Capella common stock (other than Excluded Shares) and in connection with the delivery of its opinion, dated October 29, 2017, to the Capella board of directors. These analyses do not purport to be appraisals or to reflect the prices at which shares of Strayer common stock or Capella common stock might actually trade.

The merger exchange ratio was determined through arm's-length negotiations between Strayer and Capella and was approved by the Capella board of directors. Morgan Stanley provided advice to Capella's management and the Capella board of directors during these negotiations. Morgan Stanley did not, however, recommend any specific exchange ratio to Capella, nor that any specific exchange ratio constituted the only appropriate exchange ratio for the merger. Morgan Stanley's opinion did not address the relative merits of the merger as compared to any other alternative business transaction, or other alternatives, or whether or not such alternatives could be achieved or are available. In addition, Morgan Stanley's opinion was not intended to, and did not, in any manner, address the price at which the Strayer common stock would trade following the merger or at any time, and Morgan Stanley expressed no opinion or recommendation to any holder of shares of Capella common stock or Strayer common stock as to how such holder should vote at the Capella special meeting or the Strayer special meeting, respectively, or whether to take any other action with respect to the merger.

Morgan Stanley's opinion and its oral presentation to the Capella board or directors was one of many factors taken into consideration by the Capella board of directors in deciding to approve the merger agreement and the transactions contemplated thereby. Consequently, the analyses as described above should not be viewed as determinative of the opinion of the Capella board of directors with respect to the merger exchange ratio pursuant to the merger agreement or of whether the Capella board of directors would have been willing to agree to a different exchange ratio.

Morgan Stanley's opinion was approved by a committee of Morgan Stanley investment banking and other professionals in accordance with Morgan Stanley's customary practice. Morgan Stanley is a global financial services firm engaged in the securities, investment management and individual wealth management businesses. Its securities business is engaged in securities underwriting, trading and brokerage activities, foreign exchange, commodities and derivatives trading, prime brokerage, as well as providing investment banking, financing and financial advisory services. Morgan Stanley, its affiliates, directors and officers may at any time invest on a principal basis or manage funds that invest, hold long or short positions, finance positions, and may trade or otherwise structure and effect transactions, for its own account or the accounts of its customers, in debt or equity securities or loans of Capella, Strayer or any other company, or any currency or commodity, that may be involved in the merger, or any related derivative instrument.

Under the terms of its engagement letter, Morgan Stanley provided the Capella board or directors with financial advisory services and a financial opinion described in this section and attached to this joint proxy statement/prospectus as Annex D in connection with the merger, and Capella has agreed to pay Morgan Stanley a fee, upon rendering its fairness opinion, of $1 million payable upon delivery of the opinion and creditable against the transaction fee, if applicable. If the merger is concluded, Capella has agreed to pay Morgan Stanley a transaction fee of $15 million, which is payable upon and is contingent upon the consummation of the merger. In addition, Capella has agreed to indemnify Morgan Stanley and its affiliates, their respective officers, directors, employees and agents and each person, if any, controlling Morgan Stanley or any of its affiliates against certain liabilities and expenses, including certain liabilities under the federal securities laws, relating to or arising out of Morgan Stanley's engagement.

In the two years prior to the date of Morgan Stanley's opinion, other than the services provided in connection with the merger and the opinion, Morgan Stanley has not provided financial advisory or financing services to Capella or its affiliates. During the same period, Morgan Stanley has not provided any financial advisory or financing services to Strayer or its affiliates. Morgan Stanley may seek to provide financial advisory and financing services to Strayer, Capella and their respective affiliates in the future and would expect to receive fees for the rendering of those services.

Capella Management's Unaudited Prospective Financial Information

Capella does not as a matter of course publicly disclose financial projections or forecasts as to future performances, revenues, earnings or other results given, among other things, the unpredictability of the underlying assumptions and estimates inherent in preparing financial projections and forecasts. The unaudited financial projections concerning Capella set forth below were made available, except as otherwise described below, to the board of directors of Capella in its review and evaluation of the proposed merger, to Capella's financial advisor for its use and reliance in connection with its financial analyses and opinion to the Capella board of directors described under " *Opinion of Capella's Financial Advisor*" beginning on page 82, to Strayer and to Strayer's financial advisor. The summary of these financial projections is not being included in this joint proxy statement/prospectus to influence the voting decision of any Capella shareholder or Strayer stockholder with respect to the merger, but instead because these financial projections were provided to Capella, Strayer and their respective financial advisors in connection with the proposed merger.

You should note that the financial projections set forth below constitute forward-looking statements and were not prepared with a view toward public disclosure or with a view toward complying with GAAP, the published guidelines of the SEC or the guidelines established by the American Institute of Certified Public Accountants for preparation and presentation of prospective financial information. The information was prepared utilizing Capella's historical accounting policies and does not give effect to the adoption of any new accounting pronouncements in the future, the impact of which are still being assessed. As such, the unaudited prospective financial information also was not prepared with a view toward pending or new accounting pronouncements, the published guidelines of the SEC regarding projections and forward-looking statements, or the guidelines established by the American Institute of Certified Public Accountants for preparation and presentations of financial projections. Neither Strayer's nor Capella's independent registered public accountant, nor any other independent accountants, have compiled, examined or performed any procedures with respect to the financial projections set forth below, nor have they expressed any opinion or any other form of assurance on such information or its achievability, and assume no responsibility for, and disclaim any association with, the financial projections. The prospective financial information included in this joint proxy statement/prospectus has been prepared by, and is the responsibility of, Capella's management. Ernst & Young LLP has neither audited, reviewed, examined, compiled nor applied agreed-upon procedures with respect to the accompanying prospective financial information and, accordingly, Ernst & Young LLP does not express an opinion or any other form of assurance with respect thereto. The Ernst & Young LLP report incorporated by reference in this joint proxy statement/prospectus relates to the Capella's historical financial information. It does not extend to the unaudited prospective financial information and should not be read to do so. Furthermore, the unaudited prospective financial information does not take into account any circumstances or events occurring after the date it was prepared.

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The financial projections set forth below should not be relied upon as necessarily indicative of actual future results, and readers of this joint proxy statement/prospectus are cautioned not to place undue reliance on such financial projections. The assumptions and estimates underlying the financial projections set forth below are inherently uncertain and, although considered reasonable by Capella management as of the date of their use in preparing the financial projections, are subject to significant business, economic and competitive risks and uncertainties that could cause actual results to differ materially from those contained in the financial projections set forth below, including, among others, risks and uncertainties due to general business, economic, regulatory, market and financial conditions, as well as changes in Capella's or Strayer's, or the combined company's, respective businesses, financial condition or results of operations, and other risks and uncertainties described under the heading "*Risk Factors*" beginning on page 35. Accordingly, the financial projections set forth below may not necessarily be indicative of the actual future performance of Capella, or the combined company after consummation of the merger, and actual results may differ materially from those presented. Inclusion of the financial projections set forth below should not be regarded as a representation by any person that the results projected will necessarily be achieved. Furthermore, the financial projections set forth below may differ from publicized analyst estimates and forecasts and do not take into account any circumstances or events occurring after the date they were prepared. Neither Capella nor any other person intends to update or revise the financial projections set forth below and assumes no obligation to do so.

The unaudited financial projections include several measures, including EBITDA and Free Cash Flow. "EBITDA" refers to the Capella's earnings before interest, taxes, share-based compensation, depreciation and amortization. "Free Cash Flow" refers to Capella's cash provided by operating activities less capital expenditures. Capella may calculate certain non-GAAP financial measures, including EBITDA and Free Cash Flow, using different methodologies from other companies, and Capella does not provide a reconciliation of the forward-looking non-GAAP financial measures of EBITDA and Free Cash Flow to the comparable GAAP financial measures because it is unable to reasonably predict certain items contained in the GAAP measures, including non-recurring and infrequent items that are not indicative of Capella's ongoing operations. These items are uncertain, depend on various factors and could have a material impact on Capella's GAAP results for the applicable period.

Capella's management prepared unaudited financial projections for Capella for the fiscal years ending December 31, 2017 through 2022. Capella management's standalone projections were based on numerous variables and assumptions including the following key assumptions: (1) the year-over-year rate of growth in new enrollment improving to mid-single digit in 2018 through 2022; (2) the year-over-year rate of growth in total enrollment increasing from low single digits in 2018 and 2019 to near the growth rate of new enrollment by 2021 due to the lagged impact of new enrollment growth; (3) the Post-Secondary segment revenue growth slightly below total enrollment growth due to the negative impact of degree and program mix on revenue per learner, partly offset by net price increases; (4) the Job-Ready Skills segment having double-digit annual revenue growth through 2022 but due to continued investments this segment was not forecast to materially contribute to consolidated net income growth; (5) marketing investments growing at a rate similar to new enrollment growth and above the rate of revenue growth during the forecast period; (6) efficiency gains including scale benefits partly offsetting inflation and learner growth with the annual growth rate for all expenses other than marketing forecast to be below the growth rate of consolidated revenue. The Capella board of

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directors utilized these financial projections in connection with its review and evaluation of the proposed merger. These financial projections are summarized in the following table:

	2018E	2019E	2020E	2021E	2022E
	(Dollar amounts in millions, except per share data)				
Revenue	$ 452	$ 469	$ 491	$ 515	$ 540
EBITDA(1)	98	103	109	113	118
Income from operations	72	76	81	85	89
Net Income	45	48	51	53	56
Diluted Earnings per Share	$ 3.76	$ 3.98	$ 4.26	$ 4.45	$ 4.65
Capital Expenditures	23	23	25	26	27
Free Cash Flow(2)	53	56	59	61	63

(1) Defined as earnings before interest, taxes, share-based compensation, depreciation and amortization. EBITDA is a non-GAAP financial measure and should not be considered an alternative to net income as a measure of operating performance or cash provided by operating activities as a cash flow measurement.

(2) Defined as cash provided by operating activities less capital expenditures. Free cash flow is a non-GAAP financial measure.

The Capella shareholders and the Strayer stockholders are urged to review Capella's most recent SEC filings for a description of Capella's results of operations and financial condition and capital resources during 2017, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Capella's Annual Report on Form 10-K for the year ended December 31, 2016 and subsequent Quarterly Reports on Form 10-Q, which are incorporated by reference into this joint proxy statement/prospectus. See "*Where You Can Find More Information*" beginning on page 177.

Opinion of Strayer's Financial Advisor

Strayer retained Perella Weinberg to act as its financial advisor in connection with a potential transaction with Capella. Strayer selected Perella Weinberg based on Perella Weinberg's qualifications, expertise and reputation and its knowledge of the business and affairs of Strayer and the industries in which Strayer conducts its business. Perella Weinberg, as part of its investment banking business, is continually engaged in performing financial analyses with respect to businesses and their securities in connection with mergers and acquisitions, leveraged buyouts and other transactions as well as for corporate and other purposes.

On October 27, 2017, Perella Weinberg rendered to the Strayer board of directors its oral opinion, subsequently confirmed in writing that, as of such date and based upon and subject to the various assumptions made, procedures followed, matters considered and qualifications and limitations set forth therein, the merger exchange ratio provided for in the merger agreement was fair from a financial point of view to Strayer.

The full text of Perella Weinberg's written opinion, dated October 27, 2017, which sets forth, among other things, the assumptions made, procedures followed, matters considered and qualifications and limitations on the review undertaken by Perella Weinberg, is attached hereto as Annex D and is incorporated by reference herein. Holders of Strayer common stock are urged to read Perella Weinberg's opinion carefully and in its entirety. Perella Weinberg's opinion was addressed to the Strayer board of directors for information and assistance in connection with, and for the purposes of its evaluation of, the merger. Perella Weinberg's opinion was not intended to be and does not constitute a recommendation to any holder of Strayer common stock or Capella common stock as to how such holders should vote or otherwise act with respect to the merger or any other matter and does not in any manner address the prices at which shares of Strayer common stock or Capella common

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stock will trade at any time. Perella Weinberg's opinion does not address Strayer's underlying business decision to enter into the merger agreement or the relative merits of the merger as compared with any other strategic alternative which may be available to the Strayer. Perella Weinberg was not authorized to solicit, and did not solicit, indications of interest in a transaction with Strayer from any party. In addition, Perella Weinberg expressed no opinion as to the fairness of the merger to, or any consideration received in connection with the merger by, the holders of any class of securities, creditors or other constituencies of Strayer. This summary of the opinion of Perella Weinberg is qualified in its entirety by reference to the full text of the opinion.

In arriving at its opinion, Perella Weinberg, among other things:

- reviewed certain publicly available financial statements and other business and financial information with respect to Strayer and Capella, including research analyst reports;

- reviewed certain internal financial information, analyses, forecasts (the "Strayer forecasts") and other financial and operating data relating to the business of Strayer, in each case, prepared by management of Strayer;

- reviewed certain internal financial information, analyses, forecasts (the "Capella forecasts") and other financial and operating data relating to the business of Capella, in each case, prepared by management of Capella and approved for Perella Weinberg's use by management of Strayer;

- reviewed certain publicly available financial forecasts relating to Strayer;

- reviewed certain publicly available financial forecasts relating to Capella;

- reviewed estimates of synergies anticipated by Strayer's management to result from the merger (the "anticipated synergies");

- discussed the past and current business, operations, financial condition and prospects of Strayer, including the anticipated synergies, with management of Strayer, and discussed the past and current business, operations, financial condition and prospects of Capella with management of Strayer;

- reviewed the relative financial contributions of Strayer and Capella to the future financial performance of Strayer on a pro forma basis;

- compared the financial performance of Strayer and Capella with that of certain publicly-traded companies which Perella Weinberg believed to be generally relevant;

- compared the financial terms of the merger with the publicly available financial terms of certain transactions which Perella Weinberg believed to be generally relevant;

- reviewed the historical trading prices and trading activity for the Strayer common stock and the Capella common stock, and compared such price and trading activity of the shares of Strayer common stock and Capella common stock with each other and with that of securities of certain publicly-traded companies which Perella Weinberg believed to be generally relevant;

- participated in discussions with representatives of Strayer and its and Capella's respective advisors;

reviewed a draft dated October 27, 2017 of the merger agreement; and

conducted such other financial studies, analyses and investigations, and considered such other factors, as Perella Weinberg deemed appropriate.

In arriving at its opinion, Perella Weinberg assumed and relied upon, without independent verification, the accuracy and completeness of the financial and other information supplied or otherwise made available to Perella Weinberg (including information that was available from generally recognized

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public sources) for purposes of its opinion and further relied upon the assurances of the management of Strayer that, to their knowledge, the information furnished, or approved for Perella Weinberg's use, by them for purposes of Perella Weinberg's analysis did not contain any material omissions or misstatements of material fact. Perella Weinberg assumed with the consent of the Strayer board of directors that there were no material undisclosed liabilities of Strayer or Capella for which adequate reserves or other provisions were not made. With respect to the Strayer forecasts, Perella Weinberg was advised by the management of Strayer and assumed, with the consent of the Strayer board of directors, that they were reasonably prepared on bases reflecting the best currently available estimates and good faith judgments of the management of Strayer as to the future stand-alone financial performance of Strayer and the future financial performance of Strayer and Capella taken together (except to the extent of inputs therein based solely on the Capella forecasts, as further addressed in the next two sentences), as the case may be, and the other matters covered thereby and Perella Weinberg expressed no view as to the assumptions on which they were based. With respect to the Capella forecasts, Perella Weinberg assumed, with the consent of the Strayer board of directors, that they were reasonably prepared on bases reflecting the best currently available estimates and good faith judgments of the management of Capella as to the future stand-alone financial performance of Capella and the other matters covered thereby and Perella Weinberg expressed no view as to the assumptions on which they were based. Perella Weinberg relied upon the assessment by management of Strayer that the Capella forecasts were reasonably prepared. Perella Weinberg assumed, with the consent of the Strayer board of directors, that the anticipated synergies and potential strategic implications and operational benefits (including the amount, timing and achievability thereof) anticipated by management of Strayer to result from the merger will be realized in the amounts and at the times projected by management of Strayer, and Perella Weinberg expressed no view as to the assumptions on which they were based. Perella Weinberg relied without independent verification upon the assessment by the management of Strayer of the timing and risks associated with the integration of Strayer and Capella. In arriving at its opinion, Perella Weinberg did not make any independent valuation or appraisal of the assets or liabilities (including any contingent, derivative or off-balance-sheet assets and liabilities) of Strayer or Capella, nor was Perella Weinberg furnished with any such valuations or appraisals, nor did Perella Weinberg assume any obligation to conduct, nor did Perella Weinberg conduct, any physical inspection of the properties or facilities of Strayer or Capella. In addition, Perella Weinberg did not evaluate the solvency of any party to the merger agreement, including under any state, federal or other laws relating to bankruptcy, insolvency or similar matters. Perella Weinberg assumed that the final merger agreement would not differ in any material respect from the form of merger agreement reviewed by Perella Weinberg and that the merger will be consummated in accordance with the terms set forth in the merger agreement, without material modification, waiver or delay. In addition, Perella Weinberg assumed that in connection with the receipt of all the necessary approvals of the merger, no delays, limitations, conditions or restrictions will be imposed that could have an adverse effect on Strayer, Capella or the contemplated benefits expected to be derived in the merger. Perella Weinberg relied as to all legal matters relevant to rendering its opinion upon the advice of counsel.

Perella Weinberg's opinion addressed only the fairness from a financial point of view, as of the date thereof, of the merger exchange ratio provided for in the merger agreement to Strayer. Perella Weinberg was not asked to, and did not, offer any opinion as to any other term of the merger agreement or any other document contemplated by or entered into in connection with the merger agreement or the form or structure of the merger or the likely timeframe in which the merger will be consummated. In addition, Perella Weinberg expressed no opinion as to the fairness of the amount or nature of any compensation to be received by any officers, directors or employees of any parties to the merger agreement, or any class of such persons, whether relative to the merger exchange ratio or otherwise. Perella Weinberg did not express any opinion as to any tax or other consequences that may result from the transactions contemplated by the merger agreement or any other related document, nor did Perella Weinberg's opinion address any legal, tax, regulatory or accounting matters, as to which

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Perella Weinberg understands Strayer has received such advice as it deemed necessary from qualified professionals.

Perella Weinberg's opinion was necessarily based on financial, economic, market and other conditions as in effect on, and the information made available to Perella Weinberg as of, the date of its opinion. It should be understood that subsequent developments may affect Perella Weinberg's opinion and the assumptions used in preparing it, and Perella Weinberg does not have any obligation to update, revise, or reaffirm its opinion. The issuance of Perella Weinberg's opinion was approved by a fairness opinion committee of Perella Weinberg.

Summary of Financial Analyses

The following is a summary of the material financial analyses performed by Perella Weinberg, as well as certain other analyses performed by Perella Weinberg, and reviewed by the Strayer board of directors in connection with Perella Weinberg's opinion relating to the merger and does not purport to be a complete description of the financial analyses performed by Perella Weinberg. The order of analyses described below does not represent the relative importance or weight given to those analyses by Perella Weinberg.

Some of the summaries of the financial analyses include information presented in tabular format. In order to fully understand Perella Weinberg's financial analyses, the tables must be read together with the text of each summary. The tables alone do not constitute a complete description of the financial analyses. Considering the data below without considering the full narrative description of the financial analyses, including the methodologies and assumptions underlying the analyses, could create a misleading or incomplete view of Perella Weinberg's financial analyses.

Selected Publicly-Traded Companies Analysis

Perella Weinberg performed a selected publicly-traded companies analysis, which is a method of deriving an implied value range for a company's equity securities based on a review of selected publicly-traded companies generally deemed relevant for comparative purposes. Perella Weinberg reviewed and compared certain financial information for Strayer and Capella to corresponding financial information, financial market multiples and ratios of the following selected publicly-traded companies:

- Grand Canyon Education, Inc.
- Bridgepoint Education, Inc.
- Laureate Education, Inc.
- American Public Education, Inc.
- Career Education Corporation
- Adtalem Global Education Inc.

Although none of the above companies is identical to Strayer or Capella, Perella Weinberg selected these companies because they had publicly traded equity securities and were deemed to be similar to Strayer and Capella in one or more respects, including operating in the post-secondary for-profit education sector.

For each of the selected public-traded companies, Perella Weinberg calculated and compared financial information and financial market multiples and ratios based on company filings for historical information and consensus third party research estimates for forecasted information. For Strayer and Capella, Perella Weinberg made calculations based on company filings for historical information and both consensus third party research estimates and the Strayer forecasts and the Capella forecasts for forecasted information.

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For each of Strayer, Capella and the selected publicly-traded companies, Perella Weinberg reviewed (i) the ratio of enterprise value (which represents equity value based on such company's closing share price as of October 26, 2017 plus book values of total debt and debt-like items, including preferred stock and minority interest, and less excess cash ("EV")) to estimated calendar year 2018 earnings before interest, taxes, depreciation and amortization, with stock based compensation expensed ("EBITDA") based on consensus third party research estimates and (ii) the ratio of stock market capitalization (based on such company's closing share price as of October 26, 2017) to estimated calendar year 2018 net income based on consensus third party research estimates. Perella Weinberg assumed that each of Strayer, Capella and the publicly traded companies reviewed had "excess cash" only to the extent its respective cash balance exceeded $150,000,000. The results of these analyses are summarized in the following table:

	EV / 2018E EBITDA	Stock Market Capitalization / 2018E Net Income
Grand Canyon Education Inc.	12.3x	21.6x
Bridgepoint Education, Inc.	9.1x	21.6x
Laureate Education, Inc.	7.2x	14.1x
American Public Education, Inc.	7.0x	20.3x
Career Education Corporation	7.0x	17.3x
Adtalem Global Education Inc.	7.0x	14.6x
Median of Selected Publicly-Traded Companies	7.1x	18.8x
Mean of Selected Publicly-Traded Companies	8.3x	18.3x
Strayer	11.8x	24.4x
Capella	7.9x	17.6x

Perella Weinberg also took into consideration the historical forward trading multiples over the last year for each of Strayer and Capella as well as median of the selected publicly-traded companies.

Based on the analysis of the relevant metrics described above and on professional judgments made by Perella Weinberg, Perella Weinberg selected and applied a range of multiples of 8.0x to 11.5x to 2018E EBITDA of Strayer using consensus third party research estimates and the Strayer forecasts and to 2018E EBITDA of Capella using consensus third party research estimates and the Capella forecasts. Further, based on the analysis of the relevant metrics described above and on professional judgments made by Perella Weinberg, Perella Weinberg applied a range of 17.5x to 21.5x to 2018E net income of Strayer using consensus third party research estimates and the Strayer forecasts and to 2018E net income of Capella using consensus third party research estimates and the Capella forecasts. From these analyses, Perella Weinberg derived ranges of implied equity values for each of Strayer and Capella. Perella Weinberg calculated implied values per share by dividing the implied equity values by the applicable fully diluted shares (based upon the number of issued and outstanding shares and other equity interests in each case provided by the managements of Capella and Strayer, as applicable, and

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using the treasury method for calculation of option dilution). The ranges of implied values per share derived from these calculations are summarized in the following table:

	Metric	Implied Value Range Per Share
Strayer		
Consensus third party research estimates	2018E EBITDA	$62.41 - $89.45
	2018E Net Income	$65.18 - $79.97
Strayer forecasts	2018E EBITDA	$66.84 - $95.81
	2018E Net Income	$69.90 - $85.78
Capella		
Consensus third party research estimates	2018E EBITDA	$67.45 - $94.63
	2018E Net Income	$65.02 - $79.50
Capella forecasts	2018E EBITDA	$64.88 - $90.98
	2018E Net Income	$65.79 - $80.43

Perella Weinberg compared these implied value ranges per share for Strayer common stock to both the October 26, 2017 trading price per share for Strayer common stock of $90.85 and to the value per share for Strayer common stock implied in the merger of $83.03 (the "Strayer implied merger price"). Perella Weinberg also compared these implied value ranges per share for Capella common stock to both the October 26, 2017 trading price per share for Capella common stock of $65.50 and to the value per share for Capella common stock implied in the merger of $72.65 (the "Capella implied merger price"). The Strayer implied merger price was calculated by Perella Weinberg by calculating a combined company stock market capitalization equal to the sum of the stock market capitalizations of Strayer and Capella as of October 26, 2017 and dividing this combined company stock market capitalization by the estimated number of fully diluted pro forma shares outstanding of the combined company as of October 26, 2017 including all vested and unvested stock based compensation (based upon the number of issued and outstanding shares and other equity interests in each case provided by the managements of Capella and Strayer, as applicable, and using the treasury method for calculation of option dilution). The Capella implied merger price was calculated by Perella Weinberg by applying the 0.875x merger exchange ratio to the Strayer implied merger price.

Perella Weinberg then calculated the exchange ratio ranges implied by the selected publicly-traded companies analysis. For each of the foregoing analyses, Perella Weinberg then calculated (i) the ratio of the highest implied value per share for Capella derived from the selected publicly-traded companies analysis to the lowest implied value per share for Strayer derived from the selected publicly-traded companies analysis and (ii) the ratio of the lowest implied value per share for Capella derived from the selected publicly-traded companies analysis to the highest implied value per share for Strayer derived from the selected publicly-traded companies analysis to calculate the following implied exchange ratio ranges:

	Metric	Implied Exchange Ratio Range
Consensus third party research estimates	2018E EBITDA	0.754x - 1.516x
	2018E Net Income	0.813x - 1.220x
Strayer forecasts / Capella forecasts	2018E EBITDA	0.677x - 1.361x
	2018E Net Income	0.767x - 1.151x

Perella Weinberg compared these implied exchange ratio ranges to the merger exchange ratio.

Although the selected publicly-traded companies were used for comparison purposes, no business of any selected company was either identical or directly comparable to Strayer's or Capella's business. Perella Weinberg's comparison of selected publicly-traded companies to Strayer and Capella and

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analysis of the results of such comparisons were not purely mathematical, but instead necessarily involved complex considerations and judgments concerning differences in financial and operating characteristics and other factors that could affect the relative values of the selected publicly-traded companies, Strayer and Capella.

Discounted Cash Flow Analysis

Perella Weinberg performed a discounted flow analysis, which is a method of deriving an implied value range for a company's equity securities based on the sum of the company's unlevered free cash flows over a forecast period and the terminal value at the end of the forecast period. In performing this analysis, Perella Weinberg used the Strayer forecasts and the Capella forecasts and:

- calculated, in each case, the present value as of December 31, 2017 of the estimated standalone unlevered free cash flows (calculated as operating income, including stock based compensation expense, after taxes, plus depreciation and amortization, minus capital expenditures, and adjusting for changes in net working capital) that each of Strayer and Capella could generate for fiscal year 2018 through fiscal year 2022 using the Strayer forecasts and the Capella forecasts, respectively, and using discount rates ranging from 10.75% to 11.75% for Strayer and 9.50% to 10.25% for Capella, in each case based on estimates of the weighted average cost of capital of each company; and

- calculated, in each case, a range of terminal values for each of Strayer and Capella by applying a perpetual growth rate ranging from 4.0% to 5.0% for each company and discounted using discount rates ranging from 10.75% to 11.75% for Strayer and 9.50% to 10.25% for Capella. Perella Weinberg observed the implied calculated ranges of forward exit multiples under the analysis of 6.8x to 9.1x EBITDA and 13.3x to 17.8x net income for Strayer and 7.9x to 10.9x EBITDA and 15.9x to 21.9x net income for Capella, in each case, as of 2022.

From the ranges of implied enterprise values generated by the foregoing analysis, Perella Weinberg derived ranges of implied equity values for each of Stayer and Capella by subtracting debt and debt-like items and adding excess cash. Perella Weinberg assumed that each of Strayer and Capella had "excess cash" only to the extent its respective cash balance exceeded $150,000,000. Perella Weinberg calculated implied values per share by dividing the implied equity values by the applicable fully diluted shares (based upon the number of issued and outstanding shares and other equity interests in each case provided by the managements of Capella and Strayer, as applicable, and using the treasury method for calculation of option dilution). The discounted cash flow analysis did not consider estimated synergies resulting from the proposed combination. The ranges of implied values per share derived from these calculations are summarized in the following table:

	Implied Value Range Per Share
Strayer	$64.01 - $83.25
Capella	$66.82 - $87.77

Perella Weinberg compared these implied value ranges per share for Strayer common stock and Capella common stock to the Strayer implied merger price and the Capella implied merger price, respectively.

Perella Weinberg then calculated the exchange ratio range implied by the discounted cash flow analysis, by calculating, for the foregoing analysis, (i) the ratio of the highest implied value per share for Capella derived from the discounted cash flow analysis to the lowest implied value per share for Strayer derived from the discounted cash flow analysis and (ii) the ratio of the lowest implied value per share for Capella derived from the discounted cash flow analysis to the highest implied value per share for Strayer derived from the discounted cash flow analysis to derive an implied exchange ratio range of

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0.803x to 1.371x. Perella Weinberg compared this implied exchange ratio range to the merger exchange ratio.

Exchange Ratio Over Time

Perella Weinberg observed the ratio of the price of Capella common stock to the price of Strayer common stock for October 26, 2017 as well as each of the thirty (30) day, ninety (90) day, one year and five year periods ended October 26, 2017 and since the latest U.S. presidential election through October 26, 2017. For each applicable period, Perella Weinberg divided the daily VWAP per share of Capella common stock during the applicable period by the daily VWAP per share of Strayer common stock during the applicable period to calculate the stock price ratio for that period. Perella Weinberg also calculated the percentage of the combined company that would be owned by Strayer stockholders if each observed stock price ratio were the exchange ratio applicable to the merger, assuming fully diluted shares outstanding of each company as of October 26, 2017 including all vested and unvested stock based compensation (based upon the number of issued and outstanding shares and other equity interests in each case provided by the managements of Capella and Strayer, as applicable, and using the treasury method for calculation of option dilution). The results of these calculations are summarized in the following table:

Calendar Day VWAPS to 10/26/2017	Stock Price Ratio	Implied Strayer Ownership
Current	0.722x	57%
30-Day	0.779x	55%
90-Day	0.818x	54%
Since U.S. Election	1.000x	49%
1-Year	1.014x	48%
5-Year	1.007x	49%

Perella Weinberg compared these stock price ratios to the merger exchange ratio. Perella Weinberg also compared the percentage of Strayer stockholder ownership of the combined company generated from the foregoing illustrative calculations to the implied Strayer stockholder ownership of the combined company of approximately 52%, based on an implied number of shares of Strayer common stock issued to Capella shareholders based on the merger exchange ratio and fully diluted shares outstanding (based upon the number of issued and outstanding shares and other equity interests in each case provided by the managements of Capella and Strayer, as applicable, and using the treasury method for calculation of option dilution).

Historical Stock Trading

Perella Weinberg reviewed the historical closing market prices for each of Strayer common stock and Capella common stock for the 52-week period ended October 26, 2017 and the historical closing market prices for each of Strayer common stock and Capella common stock from the date of the last

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U.S. presidential election through October 26, 2017. The high and low closing prices for each of Strayer common stock and Capella common stock for these periods are set forth on the table below:

Strayer Common Stock		
Historical Trading Period	Low Closing Price	High Closing Price
52 weeks	$56.40	$94.52
Since U.S. election	$65.75	$94.52
Capella Common Stock		
Historical Trading Period	Low Closing Price	High Closing Price
52 weeks	$65.50	$98.05
Since U.S. election	$65.50	$98.05

Perella Weinberg compared these value ranges per share for Strayer common stock and Capella common stock to the Strayer implied merger price and the Capella implied merger price, respectively.

Perella Weinberg then calculated the exchange ratio ranges implied by the historical stock trading review. Perella Weinberg calculated the ratios of (i) the highest closing market price of Capella common stock during each period to the lowest closing market price of Strayer common stock during each period and (ii) the ratio of the lowest closing market price of Capella common stock during each period to the highest closing market price of Strayer common stock during each period to derive the following implied exchange ratio ranges:

Historical Trading Period	**Implied Exchange Ratio Range**
52 weeks	0.693x - 1.738x
Since U.S. election	0.693x - 1.491x

Perella Weinberg compared these implied exchange ratio ranges to the merger exchange ratio.

Equity Research Analyst Price Target Statistics

Perella Weinberg observed the most recent publicly available research analyst price targets for Strayer common stock prepared and published by three selected equity research analysts prior to October 26, 2017. Perella Weinberg noted that the range of these recent equity analyst price targets for Strayer common stock was $80.31 to $89.07 per share, in each case as discounted to October 26, 2017 using an 11.25% cost of equity.

Perella Weinberg also observed the most recent publicly available research analyst price targets for Capella common stock prepared and published by four selected equity research analysts prior to October 26, 2017. Perella Weinberg noted that the range of these recent equity analyst price targets for Capella common stock was $71.05 to $82.25 per share, in each case as discounted to October 26, 2017 using an 9.88% cost of equity.

Perella Weinberg compared these value ranges per share for Strayer common stock and Capella common stock to the Strayer implied merger price and the Capella implied merger price, respectively.

Perella Weinberg then calculated the exchange ratio range implied by the equity research analyst price target statistics review. Perella Weinberg calculated the ratios of (i) the highest most recently publicly available research analyst price target for Capella common stock (discounted as detailed above) to the lowest most recently publicly available research analyst price target for Strayer common stock (discounted as detailed above) and (ii) the lowest most recently publicly available research analyst price target for Capella common stock (discounted as detailed above) to the highest most recently publicly available research analyst price target for Strayer common stock (discounted as detailed above) to derive an implied exchange ratio range of 0.798x to 1.024x. Perella Weinberg compared this implied exchange ratio range to the merger exchange ratio.

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The public market trading prices published by equity research analysts do not necessarily reflect current market trading prices for Strayer common stock or Capella common stock. Further, these estimates are subject to uncertainties, including the future financial performance of Strayer and Capella and future market conditions, and the public market trading price targets published by equity research analysts typically represent price targets to be achieved over a six (6) to twelve (12) month period.

Relative Contribution Analysis

Perella Weinberg reviewed the relative contribution of Strayer and Capella to the forecasted fiscal year 2018 EBITDA and net income (excluding transaction adjustments and synergies). Perella Weinberg also reviewed the relative contribution of Strayer and Capella to the combined stock market capitalization as of October 26, 2017. The estimated 2018 EBITDA and net income of Strayer and Capella were based on the Strayer forecasts and the Capella forecasts, respectively. The relative contribution analysis did not give effect to the impact of any estimated synergies resulting from the proposed combination. The results of these analyses are summarized in the following table:

	Strayer Contribution	Capella Contribution
2018E EBITDA	51%	49%
2018E Net Income	50%	50%
Stock Market Capitalization	57%	43%

Perella Weinberg compared these relative contributions to the implied Strayer stockholder and Capella shareholder ownership of the combined company of approximately 52% and 48%, respectively, based on an implied number of shares of Strayer common stock issued to Capella shareholders based on the merger exchange ratio and fully diluted shares outstanding (based upon the number of issued and outstanding shares and other equity interests in each case provided by the managements of Capella and Strayer, as applicable, and using the treasury method for calculation of option dilution).

Selected Transactions

For informational purposes only, Perella Weinberg reviewed and analyzed the financial terms of selected transactions involving companies in the post-secondary for-profit education sector that Perella Weinberg deemed relevant. However, as discussed with the Strayer board of directors, in arriving at its opinion, Perella Weinberg did not rely on a selected transactions analysis. As the proposed combination is not a change-of-control transaction, the precedent change-of-control transactions identified were not directly relevant and were not relied upon by Perella Weinberg to arrive at its opinion. Perella Weinberg also did not believe that there were any recent precedent transactions in the post-secondary for-profit education sector that were comparable to the merger due to the dramatic changes in this industry, the regulatory environment in which this industry operates and the performance of the companies operating therein since the dates of prior transactions in this industry.

Miscellaneous

The preparation of a fairness opinion is a complex process and is not necessarily susceptible to partial analysis or summary description. Selecting portions of the analyses or of the summary set forth herein, without considering the analyses or the summary as a whole, could create an incomplete view of the processes underlying Perella Weinberg's opinion. In arriving at its fairness determination, Perella Weinberg considered the results of all of its analyses and did not attribute any particular weight to any factor or analysis considered. Rather, Perella Weinberg made its determination as to fairness on the basis of its experience and professional judgment after considering the results of all of its analyses. No company or transaction used in the analyses described herein as a comparison is directly comparable to Strayer, Capella or the merger.

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Perella Weinberg prepared the analyses described herein for purposes of providing its opinion to the Strayer board of directors as to the fairness, from a financial point of view, as of the date of such opinion, of the merger exchange ratio provided in the merger agreement to Strayer. These analyses do not purport to be appraisals or necessarily reflect the prices at which businesses or securities actually may be sold. Perella Weinberg's analyses were based in part upon the Strayer forecasts and the Capella forecasts and third party research analyst estimates, which are not necessarily indicative of actual future results, and which may be significantly more or less favorable than suggested by Perella Weinberg's analyses. Because these analyses are inherently subject to uncertainty, being based upon numerous factors or events beyond the control of the parties to the merger agreement or their respective advisors, none of Strayer, Capella, Perella Weinberg or any other person assumes responsibility if future results are materially different from those forecasted by the Strayer or Capella management or third parties.

As described above, the opinion of Perella Weinberg to the Strayer board of directors was one of many factors taken into consideration by the Strayer board of directors in making its determination to approve the merger. Perella Weinberg was not asked to, and did not, recommend the merger exchange ratio provided for in the merger agreement, which consideration was determined through arms-length negotiations between Strayer and Capella. Perella Weinberg did not recommend any specific exchange ratio to the holders of Strayer common stock or the Strayer board of directors or that any specific exchange ratio constituted the only appropriate exchange ratio or consideration for the merger.

Pursuant to the terms of the engagement letter between Perella Weinberg and Strayer dated October 6, 2017, Strayer paid Perella Weinberg a retainer fee in the amount of $500,000 and further agreed to pay Perella Weinberg $2,500,000 upon the delivery of Perella Weinberg's opinion and an additional transaction fee of $8,000,000 upon the consummation of the merger. Strayer has agreed to pay Perella Weinberg a fee equal to 20% of any break-up, termination, topping or similar fee received by Strayer upon receipt thereof, provided that such fee may not exceed the expected total transaction fee that would have been received if the merger had been consummated. In addition, Strayer agreed to reimburse Perella Weinberg for its reasonable out-of-pocket expenses, and to indemnify Perella Weinberg and related persons for certain liabilities and other items that may arise out of its engagement by Strayer and the rendering of its opinion. None of these payments affected Perella Weinberg's analysis or opinion.

During the two year period prior to the date hereof, neither Perella Weinberg nor its affiliates have had material relationships, other than the services provided in connection with the merger and the rendering of its opinion, with Strayer, Capella or their respective affiliates for which compensation was received or is intended to be received by Perella Weinberg or its affiliates. Perella Weinberg and its affiliates may in the future provide investment banking and other financial services to Strayer, Capella and their respective affiliates and in the future may receive compensation for the rendering of such services. In the ordinary course of their business activities, Perella Weinberg or its affiliates may at any time hold long or short positions, and may trade or otherwise effect transactions, for their own accounts or the accounts of customers or clients, in debt or equity or other securities (or related derivative securities) or financial instruments (including bank loans or other obligations) of Strayer, Capella or any of their respective affiliates.

Strayer Management's Unaudited Prospective Financial Information

Although Strayer periodically may issue limited financial guidance to investors, Strayer does not as a matter of course make public long-term projections as to future revenue, earnings or other results, due to, among other reasons, the uncertainty of the underlying assumptions and estimates. However, Strayer's management prepared and reviewed with Strayer's board of directors unaudited 5-year standalone prospective financial information regarding Strayer's operations for fiscal years 2018 through 2022 (the "Strayer standalone projections"), which were provided to Strayer's financial advisor, Perella Weinberg, in connection with Perella Weinberg's financial analyses.

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The Strayer standalone projections were also provided to Capella for its use in connection with its evaluation of the merger and for the use of Capella's financial advisor in connection with its financial analyses. For more information, see the section entitled " *Background of the Merger.*"

The below summary of the Strayer standalone projections are included for the purpose of providing stockholders access to certain nonpublic information that was furnished to certain parties in connection with the merger, and such information may not be appropriate for other purposes, and is not included to influence the voting decision of any Strayer stockholder or Capella shareholder.

The below unaudited prospective financial information was not prepared with a view toward public disclosure, nor was it prepared with a view toward compliance with GAAP. The information was prepared utilizing Strayer's historical accounting policies and does not give effect to the adoption of any new accounting pronouncements in the future, the impact of which are still being assessed. As such, the unaudited prospective financial information also was not prepared with a view toward or pending new accounting pronouncements, the published guidelines of the SEC regarding projections and forward-looking statements, or the guidelines established by the American Institute of Certified Public Accountants for preparation and presentations of financial projections. The inclusion of this unaudited prospective financial information should not be regarded as an indication that such information is predictive of actual future events or results and such information should not be relied upon as such, and readers of this joint proxy statement/prospectus are cautioned not to place undue reliance on the prospective financial information. Furthermore, the unaudited prospective financial information does not take into account any circumstances or events occurring after the date it was prepared. The prospective financial information included in this joint proxy statement/prospectus has been prepared by, and is the responsibility of, Strayer's management. PricewaterhouseCoopers LLP has neither audited, reviewed, examined, compiled nor applied agreed-upon procedures with respect to the accompanying prospective financial information and, accordingly, PricewaterhouseCoopers LLP does not express an opinion or any other form of assurance with respect thereto. The PricewaterhouseCoopers LLP report incorporated by reference in this joint proxy statement/prospectus relates to the Strayer's historical financial information. It does not extend to the unaudited prospective financial information and should not be read to do so.

While presented with numeric specificity, this unaudited prospective financial information was based on numerous variables and assumptions (including assumptions related to industry performance and general business, economic, market and financial conditions and additional matters specific to Strayer's business) that are inherently subjective and uncertain and are beyond the control of Strayer's management. Important factors that may affect actual results and cause this unaudited prospective financial information not to be achieved include, but are not limited to, risks and uncertainties relating to Strayer's business (including Strayer's ability to achieve strategic goals, objectives and targets over applicable periods), industry performance, general business and economic conditions and other factors described in the sections entitled "*Cautionary Statement Regarding Forward-Looking Statements*" and "*Risk Factors*." This unaudited prospective financial information also reflects numerous variables, expectations and assumptions available at the time they were prepared as to certain business decisions that are subject to change and the Strayer standalone projections are based solely on the information available to Strayer's management at the time they were prepared. As a result, actual results may differ materially from those contained in this unaudited prospective financial information. Accordingly, there can be no assurance that the projected results summarized below will be realized. Strayer stockholders and Capella shareholders are urged to review the most recent SEC filings of Strayer for a description of the reported results of operations and financial condition and capital resources of Strayer, including in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Strayer's Annual Report on Form 10-K for the year ended December 31, 2016, and any subsequent quarterly reports on Form 10-Q, which are incorporated by reference into this joint proxy statement/prospectus.

None of Strayer, Capella or their respective officers, directors, affiliates, advisors or other representatives can give you any assurance that actual results will not differ materially from this unaudited prospective financial information. Strayer undertakes no obligation to update or otherwise revise or reconcile this unaudited prospective financial information to reflect circumstances existing after the date this unaudited prospective financial information was generated or to reflect the occurrence of future events, even in the event that any or all of the assumptions underlying such information are shown to be in error. Since the unaudited prospective financial information covers multiple years, such information by its nature becomes less predictive with each successive year.

Strayer may calculate certain non-GAAP financial metrics, including EBITDA and Distributable Free Cash Flow, using different methodologies from Capella and from other companies. Consequently, the financial metrics presented in Strayer's and Capella's prospective financial information disclosures and in the sections of this joint proxy statement/prospectus with respect to the opinions of the financial advisors to Strayer and Capella may not be directly comparable to one another. Strayer is not providing a quantitative reconciliation of the forward looking non-GAAP financial metrics set forth below.

Strayer has not made and makes no representation to Capella or any Strayer stockholder or Capella shareholder, in the merger agreement or otherwise, concerning this unaudited prospective financial information or regarding Strayer's ultimate performance compared to the unaudited prospective financial information or that the projected results will be achieved. In light of the foregoing factors and the uncertainties inherent in the unaudited prospective financial information, Strayer urges all Strayer stockholders and Capella shareholders not to place undue reliance on such information and to review Strayer's and Capella's most recent SEC filings for a description of Strayer's and Capella's reported financial results.

Strayer Standalone Projections

The following is a summary of the Strayer standalone projections. The Strayer standalone projections were based on numerous variables and assumptions, including the following key assumptions:

Approximately 5% new student growth in 2018 and 2019, followed by 3.75% new student growth in 2020 to 2022, resulting from expansion of new programs such as Nursing, Digital Entrepreneurship, and Applied Sciences as well as continued growth in our core Business and IT program offerings

Increases in marketing costs are expected to outpace new student enrollment by approximately 4% due to inflation in cost per inquiry and additional marketing investment to support new program launches

Continued investment in course content, faculty performance, and the collection and use of data analytics will continue to drive improvement in student retention of approximately 0.25% per year

New student growth combined with retention improvements result in approximately 6% total enrollment growth per year

Growth in tuition discounts associated with corporate partnerships as well as scholarship programs targeting highly qualified student populations will result in continued declines in revenue per student through 2021. Declines in revenue per student expected to be in the 1 to 3% range in 2018 to 2019, then flatten to 1% to 0% in 2020 to 2022

Non-marketing expense inflation of 2 to 3% per year. Ability to scale classroom experience results in operating margins expansion to 18% in 2022

Assumed tax rate of 39.5%

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Capital expenditures in the range of 3% to 4% of revenue

The following table presents (in millions, except per share amounts) a summary of the Strayer standalone projections, as prepared by Strayer's management, with all figures (except per share amounts) rounded to the nearest million. The projections included in the below table treat Strayer on a standalone basis, without giving effect to the merger and were prepared as if the merger had not been contemplated.

	2018E	2019E	2020E	2021E	2022E
	(Dollar amounts in millions, except per share data)				
Revenue	$ 476	$ 502	$ 529	$ 557	$ 583
EBITDA(1)	108	113	122	130	139
Income from operations	75	82	89	97	106
Net Income	46	50	54	59	64
Diluted Earnings Per Share	$ 4.00	$ 4.35	$ 4.75	$ 5.18	$ 5.63
Capital Expenditures	17	18	19	19	20
Distributable Free Cash Flow(2)	61	68	65	69	74

(1) Defined as earnings before interest, taxes, share-based compensation, depreciation and amortization. EBITDA is a non-GAAP financial measure and should not be considered an alternative to net income as a measure of operating performance.

(2) Defined as cash provided by operating activities less capital expenditures. Distributable free cash flow is a non-GAAP financial measure and should not be considered an alternative to cash provided by operating activities as a cash flow measurement.

Board and Management of the Combined Company

Board of Directors of the Combined Company after the Merger

At the effective time, the board of directors of the combined company will consist of (a) nine directors designated by Strayer, (b) J. Kevin Gilligan, Chief Executive Officer of Capella, and (c) two additional designees who are currently members of the Capella board of directors and are recommended by Mr. Gilligan. In addition, one of the two additional Capella designees will be appointed to serve on the Compensation Committee of the combined company.

Robert Silberman will continue as Executive Chairman of the board of directors of the combined company and at the effective time, Mr. Gilligan will be appointed as Vice Chairman. For a further description of governance of the combined company following the consummation of the merger, see "*Description of Combined Company Shares*" and "*Comparison of Stockholder Rights*."

The remaining members of the current Strayer board of directors and Capella board of directors to be designated by Strayer and Capella, respectively, as members of the combined company board of directors have not been selected as of the date of this joint proxy statement/prospectus. Biographical information for Mr. Silberman and the other members of the current Strayer board of directors is included in Strayer's Definitive Proxy Statement for its 2017 Annual Meeting of Stockholders, filed with the SEC on March 16, 2017, portions of which are incorporated by reference in this joint proxy statement/prospectus. Biographical information for Mr. Gilligan and the other members of the current Capella board of directors is included in Capella's Definitive Proxy Statement for its 2017 Annual Meeting of Shareholders, filed with the SEC on March 23, 2017, portions of which are incorporated by reference in this joint proxy statement/prospectus.

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Officers of the Combined Company after the Merger

As of the effective time, Robert Silberman will continue as Executive Chairman of the board of directors of the combined company and Mr. Gilligan will be appointed as Vice Chairman at the effective time. Karl McDonnell, Strayer's current President and Chief Executive Officer, and Daniel W. Jackson, Strayer's current Executive Vice President and Chief Financial Officer, will continue in their respective positions at the combined company following the effective time. Steven L. Polacek, Capella's current Senior Vice President and Chief Financial Officer will be appointed as the Chief Integration/Transition Officer of the combined company.

Biographical information for those executive officers named above and not included in the companies' respective annual meeting proxy statements as described under " *Board of Directors of the Combined Company after the Merger*" is incorporated by reference from Strayer's Annual Report on Form 10-K for the year ended December 31, 2016, filed with the SEC on February 17, 2017 (with respect Messrs. McDonnel and Jackson), and Capella's Annual Report on Form 10-K for the year ended December 31, 2016, filed with the SEC on February 22, 2017 (with respect to Mr. Polacek).

Interests of Capella's Directors and Executive Officers in the Merger

In considering the recommendation of Capella's board of directors with respect to adopting the Capella Proposals, Capella stockholders should be aware that certain members of the Capella board of directors and executive officers may have interests in the merger that are different from, or are in addition to, interests of Capella stockholders generally. These interests may create an appearance of a conflict of interest. The Capella board of directors was aware of these potential conflicts of interests during its deliberations on the merits of the merger and in making its decisions in approving the merger, the merger agreement, and the related transactions. These potential conflicts of interests are described in more detail below, and certain potential conflicts of interest are quantified in the tables in the section entitled "*Capella Proposals Capella Proposal 3: The Capella Advisory Compensation Proposal*" beginning on page 51.

Treatment of Capella Equity Awards in the Merger

Under the merger agreement, at the effective time, Strayer will assume all the obligations of Capella under the Capella 2005 Stock Incentive Plan and 2014 Equity Incentive Plan, and each Capella stock option and Capella RSU will be assumed by Strayer and converted into a comparable Strayer form of equity award based upon the merger exchange ratio but otherwise subject to the same terms and conditions as set forth under the award prior to the conversion, except that each Capella stock option held by a Capella non-employee director who will not be a member of the Strayer board of directors immediately following the effective time will be cancelled and converted into the right to receive the merger consideration the non-employee director would have been entitled to receive if the Capella stock option had been exercised for shares of Capella common stock immediately prior to the effective time of the merger (net of the applicable exercise price). In addition, unvested Capella RSUs held by Capella non-employee directors will vest in full immediately prior to the effective time of the merger.

The following table sets forth, for each of Capella's directors and executive officers (including two former directors who are required by SEC rules to be included), the number of shares of Capella common stock subject to vested and unvested Capella stock options and Capella RSUs (including Mr. Gilligan's market stock unit award) held by the director or executive officer as of November 15, 2017, the latest practicable date to determine such amounts before the filing of this joint proxy

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statement/prospectus. Depending on when the closing date occurs, certain equity-based awards shown in the table may vest in accordance with their terms prior to the closing date.

Name	Vested Stock Options (#)	Unvested Stock Options (#)	Vested Restricted Stock Units (#)	Unvested Restricted Stock Units (#)
J. Kevin Gilligan	57,845	116,086		139,878
Steven L. Polacek	7,452	50,457		15,686
Renee L. Jackson	3,719	12,963		4,173
Peter M. Ramstad	4,013	20,302		7,375
Andrew E. Watt		12,307		6,907
Richard P. Senese, PhD	1,102	4,511		1,368
Rita D. Brogley			1,844	1,054
H. James Dallas				1,054
Matthew W. Ferguson				
Michael A. Linton				1,054
Michael L. Lomax			5,465	1,054
Jody G. Miller			1,894	1,054
Stephen G. Shank				
David W. Smith			1,727	1,054
Jeffrey W. Taylor			5,465	1,054
Darrell R. Tukua				1,054

As mentioned above, except with respect to unvested Capella RSUs held by Capella non-employee directors (which will vest in full in connection with the merger), Capella equity awards will be converted into Strayer equity awards. The aggregate value of Capella equity awards, assuming a price per share of Capella common stock equal to $82.37 (which is equal to the average closing price of a share of Capella common stock on the NASDAQ over the first five business days following October 30, 2017, the date of the first public announcement of entering into the merger agreement), held by Capella's executive officers and directors is $19,386,402 and $2,045,000, respectively.

Senior Executive Severance Plan

Capella's Senior Executive Severance Plan provides severance pay and other benefits to certain eligible employees, including each of Capella's executive officers.

Under the Senior Executive Severance Plan, in the event there is a change in control (which would include the merger), and the executive experiences a voluntary termination of employment for good reason or an involuntary termination other than for cause, in either case within 24 months following the change in control, the executive will be eligible to receive the following (subject to the executive's timely execution and non-revocation of a release of claims):

- Cash severance pay equal to the sum of 24 months of the executive's base salary and two times the executive's target bonus for the year of termination;

- Outplacement assistance for up to twelve (12) months; and

- Capella-subsidized continuation coverage under Capella's health, dental and life insurance benefit plans for up to eighteen (18) months.

Cash severance benefits that may be due under the Senior Executive Severance Plan are calculated based on the greater of the executive's base salary and targeted annual bonus, as applicable, in effect immediately prior to the closing of the change in control or the date of the executive's termination of employment.

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For purposes of the Senior Executive Severance Plan, "good reason" means (i) the material reduction of the executive's job responsibilities upon or after a change in control; (ii) the material diminution of the executive's base compensation; or (iii) a reassignment of the executive's principal place of work, without the executive's consent, to a location more than 50 miles from the executive's principal place of work upon or after a change in control.

For purposes of the Senior Executive Severance Plan, "cause" means the executive's (i) commission of a crime or other act that could materially damage the reputation of Capella; (ii) theft, misappropriation or embezzlement of Capella property; (iii) falsification of records maintained by Capella; (iv) failure substantially to comply with the written policies and procedures of Capella as they may be published or revised from time to time (in writing, on the Faculty Center website, or on the Stella intranet); (v) misconduct directed toward learners, employees or adjunct faculty; or (vi) failure substantially to perform the material duties of the executive's employment, which failure is not cured within 30 days after written notice from Capella specifying the act of non-performance.

For an estimate of the value of the payments and benefits described above that would become payable under the Senior Executive Severance Plan to Messrs. Gilligan, Polacek, Ramstad and Watt and Ms. Jackson, see "*The Capella Advisory Compensation Proposal Compensation Tables Required by Item 402(t)*" above. The aggregate value of the payments and benefits that would become payable to Dr. Senese, Capella's other executive officer, assuming that the effective time is November 15, 2017 and Dr. Senese experienced a termination without "cause" or resignation with "good reason" on such date, is $880,145. This estimate is based on compensation and benefit levels that are in effect on November 15, 2017. Therefore, if compensation and benefit levels are changed after such date, the actual value of Dr. Senese's severance payments and benefits may be different from those provided for above.

J. Kevin Gilligan Employment Agreement

Under the terms of Capella's employment agreement with Mr. Gilligan, in the event of Mr. Gilligan's involuntary termination of employment without cause, as defined in the Senior Executive Severance Plan, the severance payable to Mr. Gilligan will be not less than an amount equal to three times Mr. Gilligan's annualized base salary in effect immediately prior to the date of termination of Mr. Gilligan's employment.

J. Kevin Gilligan Strategic Transformation Award

Under the terms of Mr. Gilligan's market stock unit award, in the event of a change in control (which would include the merger), if Mr. Gilligan's employment is terminated without cause or he resigns for good reason, in either case within three years following the change in control, then the award will vest in full. As the merger is not expected to be consummated until the third quarter of 2018, this award is expected to vest pursuant to its terms prior to the expected closing date of the merger.

For purposes of Mr. Gilligan's market stock award, "good reason" is defined as a material demotion or material reduction of the job responsibilities of Mr. Gilligan or the reassignment without Mr. Gilligan's consent, of Mr. Gilligan's place of work to a location more than 50 miles from Mr. Gilligan's place of work immediately prior to the change in control, provided that none of these conditions shall constitute "good reason" unless Mr. Gilligan first gives written notice to Capella within 90 days of the first occurrence of the condition, delineating the claimed breach and setting forth Mr. Gilligan's intention to terminate Mr. Gilligan's employment if such breach is not duly remedied within 30 business days, and Capella fails to cure the condition within such 30-day period. For purposes

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of Mr. Gilligan's market stock award, "cause" has the same meaning as set forth in Capella's 2005 Stock Incentive Plan.

Annual Management Incentive/Long-Term Performance Cash Programs

Under the terms of Capella's annual management incentive program, in the event an executive's employment terminates due to an involuntary termination without "cause" (as defined in the Senior Executive Severance Plan) during the performance period, the executive will be eligible to receive a prorated portion of the final calculated payment under the program in a single lump sum cash payment when payments are made to other participants following the end of the performance period.

Under the terms of Capella's long-term performance cash programs, in the event of a change in control, the executive will be eligible to receive a pro-rata lump sum cash payment, based on actual achieved performance for the truncated performance cycle, which will be calculated immediately prior to the closing date. Payments under Capella's long-term performance cash programs will be made in a single lump sum cash payment within 75 days following the closing date.

For an estimate of the value of the payments described above that would become payable to Messrs. Gilligan, Polacek, Ramstad and Watt and Ms. Jackson under Capella's annual management incentive program and long-term performance cash programs, see "*The Capella Advisory Compensation Proposal Compensation Tables Required by Item 402(t)*" above. The value of the payment that would become payable to Dr. Senese under Capella's annual management incentive program, assuming that the effective time is November 15, 2017 and Dr. Senese experienced a termination without "cause" on such date, is $87,801. The value of the payment that would become payable to Dr. Senese under Capella's long-term performance cash programs, assuming that the effective time is November 15, 2017 is $24,453. Both estimates assume the actual achievement of performance goals through November 15, 2017 applicable to each award.

Equity Plans

Awards granted under the Capella 2014 Equity Incentive Plan generally will vest in full upon a termination of employment without cause within the one year following a change in control. Awards granted under the Capella 2005 Stock Incentive Plan will vest in full upon a termination without "cause" or for "good reason" within three (3) years following a change in control.

For purposes of the 2005 Stock Incentive Plan, "cause" means (i) the executive's failure or refusal substantially to perform the executive's duties to the full extent of the executive's abilities for reasons other than death or disability, after written notice to the executive of such failure or refusal providing the executive 30 days to take corrective action; (ii) conviction of a felony crime, or commission of any act, the conviction for which would be a felony conviction; (iii) theft or misappropriation of Capella's property; or (iv) knowingly making a material false written statement to the Capella board of directors regarding the affairs of Capella. For purposes of the agreements under the 2005 Stock Incentive Plan, "good reason" means the demotion or reduction of the job responsibilities of the executive or the reassignment, without the executive's consent, of the executive's place of work to a location more than 50 miles from his or her place of work immediately prior to the change in control.

For purposes of the 2014 Equity Incentive Plan, "good reason" means the occurrence of one or more of the following events, so long as the executive provided written notice to Capella of the event not later than 30 days after it occurred and the condition resulting from the event has not been remedied by Capella within 30 days after its receipt of such notice: (i) a material reduction of the executive's job responsibilities upon or after the change in control; (ii) a material diminution of the executive's base compensation; or (iii) a reassignment of the executive's principal place of work, without the executive's consent, to a location more than 50 miles from the executive's principal place of work upon or after the change in control. For purposes of the 2014 Equity Incentive Plan, "cause"

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means what the term is expressly defined to mean in a then-effective written agreement (including an award agreement issued pursuant to the 2014 Equity Incentive Plan) between the executive and Capella or any affiliate, or in the absence of any such then-effective agreement or definition means (i) the executive's failure or refusal substantially to perform the executive's duties to the full extent of the executive's abilities for reasons other than death or disability, after written notice to the executive of such failure or refusal providing the executive 30 days to take corrective action; (ii) conviction of a felony crime, or commission of any act, the conviction for which would be a felony conviction; (iii) theft or misappropriation of Capella's property; or (iv) knowingly making a material false written statement to the Capella board of directors regarding the affairs of Capella.

J. Kevin Gilligan and Steven L. Polacek Transition Agreements

In connection with the merger, Capella entered into transition agreements with each of Messrs. Gilligan and Polacek. The agreements set forth the compensatory terms for Messrs. Gilligan and Polacek's continued service with the combined company. The agreements provide that Messrs. Gilligan and Polacek will continue as employees of Capella for twelve (12) months following the consummation of the merger, which may be extended for up to an additional six (6) months upon the agreement of the parties, or an earlier mutually agreed upon date. During this transition period, Mr. Gilligan will have the title of Vice Chairman and will serve on the combined company board of directors and Mr. Polacek will have the title of Chief Integration Officer. The agreements provide that Mr. Gilligan's base salary and target annual bonus amount for his continued service in such capacity will be $700,000 and 125% of base salary, respectively, and Mr. Polacek's base salary and target annual bonus amount for his continued service in such capacity will be $400,000 and 75% of base salary, respectively. Under the agreements, Messrs. Gilligan and Polacek also agree to provide certain ongoing transition assistance and to comply with certain confidentiality, non-compete and non-solicitation covenants.

The agreements also provide that upon Messrs. Gilligan and Polacek's termination of employment for any reason other than for "cause" (as defined in the Senior Executive Severance Plan), including due to their voluntary resignation, and subject to and conditioned upon the executive's execution and non-revocation of a general release of claims against Capella, Strayer and their subsidiaries and affiliates, each of Messrs. Gilligan and Polacek will be entitled to receive the payments and benefits afforded to them pursuant to the Senior Executive Severance Plan, the Capella 2005 Stock Incentive Plan and 2014 Equity Incentive Plan (and any applicable award agreements thereunder), and, in the case of Mr. Gilligan, his employment agreement with Capella.

Andrew E. Watt Letter Agreement

In connection with the merger, Capella entered into a letter agreement with Andrew E. Watt, which provides that if Mr. Watt remains employed for eighteen (18) months following the consummation of the merger, and agrees to waive any rights Mr. Watt may have to resign for "good reason" (as defined in the Senior Executive Severance Plan) as a result of any reduction in Mr. Watt's job responsibilities, he will have the right to terminate his employment other than for good reason, effective at any time from the date that is eighteen (18) months following the consummation of the merger until the second annual anniversary of the consummation of the merger, and will receive severance benefits pursuant to the Senior Executive Severance Plan equal to the benefits Mr. Watt would have received under that plan if Mr. Watt had terminated employment for good reason immediately following the consummation of the merger.

Employee Benefits

The merger agreement requires Strayer (or the surviving corporation of any subsidiary thereof) to continue to provide certain compensation and benefits for at least a period of one (1) year following the closing date, as well as take certain actions in respect of employee benefits provided to Capella employees, including its executive officers. For a detailed description of these requirements, please see the section entitled "*The Merger Agreement Employee Matters*" beginning on page 134.

Interests of Strayer's Directors and Executive Officers in the Merger

Strayer's directors and executive officers will not receive any special compensation the payment of which is contingent upon consummation of the merger. Nevertheless, Strayer's directors and executive officers may have interests in the merger that are different from Strayer stockholders generally because Strayer's directors and executive officers may continue employment or service with Strayer following the effective time and will be eligible to receive compensation and benefits consistent with their position and duties to Strayer. Additionally, certain of Strayer's executive officers may receive compensation under Strayer's executive compensation programs attributable to additional responsibilities in connection with the merger and subsequent integration process. Further, Strayer's directors and executive officers will continue to receive indemnification and insurance under Strayer's policies currently in effect. Any compensation and benefits that may be received by Strayer's directors and executive officers will be granted and paid pursuant to Strayer's director and executive officer compensation programs, which are described in further detail in Strayer's Definitive Proxy Statement for its 2017 Annual Meeting of Shareholders, filed with the SEC on March 16, 2017, portions of which are incorporated herein by reference.

Board Service Following the Merger

Prior to the consummation of the merger, the Strayer board of directors will appoint the members of the board of directors of the combined company, which will consist of (a) nine directors designated by Strayer, (b) J. Kevin Gilligan, Chief Executive Officer of Capella, and (c) two additional designees who are currently members of the Capella board of directors and are recommended by Mr. Gilligan, as described in more detail in the section entitled "*The Merger Agreement Post-Closing Governance*."

Regulatory Approvals Required for the Merger

United States Antitrust

Under the HSR Act, the merger cannot be consummated until, among other things, notifications have been given and certain information has been furnished to the FTC and the Antitrust Division of the DOJ and all applicable waiting periods have expired or been terminated.

The Antitrust Division of the DOJ, the FTC and others may challenge the combination on antitrust grounds even after termination of the waiting period. At any time before or after the consummation of the merger, any of the Antitrust Division of the DOJ, the FTC or another person could take action under the antitrust laws as it deems necessary or desirable in the public interest, including, without limitation, seeking to enjoin the consummation of the merger, seeking a rescission or other unwinding of the combination, or permitting consummation subject to regulatory concessions or conditions. There can be no assurance that a challenge to the combination will not be made or that, if a challenge is made, it will not succeed.

On November 9, 2017, each of Capella and Strayer filed a Pre-Merger Notification and Report Form pursuant to the HSR Act with the Antitrust Division of the DOJ and the FTC.

Education Regulatory Approvals

The merger agreement provides that the merger is conditioned upon receipt of regulatory approval from the DOE and the HLC, which is the institutional accreditor for Capella University, and from certain state agencies. In addition, Strayer is notifying all of the educational regulatory agencies that

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approve Strayer University of the merger. Although it is not expected that the merger constitutes a change of control for Strayer University that would require approval of any such agency, it is possible that some of those agencies may require approval of the merger or subject Strayer University to a review in connection with the merger. Capella and Strayer have begun the process of notifying their respective regulatory agencies of the merger and, as appropriate, seeking required approvals, and will continue to take all necessary actions required by their respective regulatory agencies prior to consummation of the merger.

The merger agreement requires that the parties cooperate to submit a pre-acquisition review application to the DOE with respect to Capella University no later than thirty (30) days after the date of the merger agreement, and to submit an application to the HLC no later than December 1, 2017. As a condition of the merger, Capella must receive from the DOE a written response to its preacquisition review application that does not indicate the existence of any impediment to the issuance of the temporary provisional program participation agreement following consummation of the merger that would reasonably be expected to result in a combined company material adverse effect, or any terms or conditions that would reasonably be expected to result in a combined company material adverse effect, as described in the merger agreement. See "*The Merger Agreement Conditions to Consummation of the Merger*" beginning on page 121. In addition, required pre-closing approvals from certain other regulatory agencies may be required as a condition of consummation of the merger, and those approvals cannot be subject to conditions that would reasonably be expected to result in a combined company material adverse effect. Certain other regulatory agencies may require approval or notification of the merger after the consummation of the merger, but must not provide any indication prior to consummation of the merger that either (i) such approval will not be granted or (ii) that such approval will be granted with terms or conditions that would reasonably be expected to result in a combined company material adverse effect.

There can be no assurance that all of the regulatory approvals described above, or any other regulatory approvals that might be required to consummate the merger, will be obtained and, if obtained, there can be no assurance as to the timing of any approvals, ability to obtain the approvals on satisfactory terms, or that the conditions will not result in the abandonment of the merger. See the section of this joint proxy statement/prospectus entitled "*The Merger Agreement Conditions to Consummation of the Merger*" beginning on page 121.

Accounting Treatment

The combined company will account for the merger using the acquisition method of accounting in accordance with GAAP. GAAP requires that one of Strayer or Capella be designated as the acquirer for accounting purposes based on the evidence available. Strayer will be treated as the acquiring entity for accounting purposes. In identifying Strayer as the acquiring entity, the combined company took into account the structure of the merger, the composition of the combined company board of directors and the designation of certain senior management positions of the combined company. Accordingly, the historical financial statements of Strayer will become the historical financial statements of the combined company.

The combined company will measure Capella's assets acquired and liabilities assumed at their fair values, including net tangible and identifiable intangible assets acquired and liabilities assumed, as of the consummation of the merger. Any excess of the purchase price over those fair values will be recorded as goodwill.

Definite lived intangible assets will be amortized over their estimated useful lives. Intangible assets with indefinite useful lives and goodwill will not be amortized but will be tested for impairment at least annually. All intangible assets and goodwill are also tested for impairment when certain indicators are present.

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The allocation of purchase price reflected in the unaudited pro forma combined financial statements is based on preliminary estimates using assumptions Strayer management believes are reasonable based on currently available information. The final purchase price and fair value assessment of assets and liabilities will be based in part on a detailed valuation that has not yet been completed.

Listing of Combined Company Shares

The merger agreement obligates Strayer to use its reasonable best efforts to cause the combined company shares to be issued in connection with the merger (including combined company shares to be issued upon exercise or vesting, as applicable, of Strayer equity awards) to be listed on NASDAQ (or such other stock exchange as may be mutually agreed upon by Capella and Strayer), subject to official notice of issuance, prior to the effective time. Approval for listing on NASDAQ of the combined company shares issuable to Capella shareholders in connection with the merger, subject to official notice of issuance, is a condition to the obligations of Capella, Strayer and Merger Sub to consummate the merger. It is expected that, following the merger, the combined company shares will be listed on NASDAQ and trade under the symbol "STRA."

Delisting and Deregistration of Capella Common Stock

Following the merger, shares of Capella common stock will be delisted from NASDAQ, deregistered under the Exchange Act and cease to be publicly traded.

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MATERIAL U.S. FEDERAL INCOME TAX CONSEQUENCES

The following is a general discussion of the material U.S. federal income tax consequences of the merger to U.S. Holders of shares of Capella common stock that exchange their shares of Capella common stock for combined company shares in the merger. This discussion is based on the Code, U.S. Treasury regulations promulgated thereunder and judicial and administrative authorities, rulings and decisions, all as in effect as of the date of this joint proxy statement/prospectus. These authorities may change, possibly with retroactive effect, and any such change could affect the accuracy of this discussion. This discussion assumes that the merger will be consummated in accordance with the merger agreement and as further described in this joint proxy statement/prospectus. This discussion is not a complete description of all of the tax consequences of the merger and, in particular, does not address any tax consequences arising under the unearned income Medicare contribution tax pursuant to the Health Care and Education Reconciliation Act of 2010, nor does it address any tax consequences arising under the laws of any state, local or non-U.S. jurisdiction, or under any U.S. federal laws other than those pertaining to the income tax.

This discussion applies only to U.S. Holders of shares of Capella common stock who hold such shares as a capital asset within the meaning of Section 1221 of the Code (generally, property held for investment). Further, this discussion does not purport to address all aspects of U.S. federal income taxation that may be relevant to U.S. Holders of shares of Capella common stock in light of their particular circumstances and does not apply to U.S. Holders of shares of Capella common stock subject to special treatment under the U.S. federal income tax laws (such as, for example, banks and other financial institutions, tax-exempt organizations, partnerships, S corporations or other pass-through entities (or investors in partnerships, S corporations or other pass-through entities), regulated investment companies, real estate investment trusts, controlled foreign corporations, passive foreign investment companies, insurance companies, mutual funds, dealers or brokers in stocks and securities, commodities or currencies, traders in securities that elect to apply a mark-to-market method of accounting, holders subject to the alternative minimum tax, holders who acquired shares of Capella common stock pursuant to the exercise of employee stock options, through a tax qualified retirement plan or otherwise as compensation, holders who actually or constructively own more than 5% of the outstanding stock of Capella, persons that are not U.S. Holders, U.S. Holders whose functional currency is not the U.S. dollar, holders who hold shares of Capella common stock as part of a hedge, straddle, constructive sale, conversion or other integrated transaction, or United States expatriates).

For purposes of this discussion, the term "U.S. Holder" means a beneficial owner of shares of Capella common stock, as applicable, that is, for U.S. federal income tax purposes, (i) an individual citizen or resident of the United States, (ii) a corporation, or entity treated as a corporation for U.S. federal income tax purposes, organized under the laws of the United States, any state thereof or the District of Columbia, (iii) a trust if (a) a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust or (b) such trust has made a valid election to be treated as a U.S. person for U.S. federal income tax purposes or (iv) an estate, the income of which is subject to U.S. federal income tax regardless of its source.

If an entity or arrangement treated as a partnership for U.S. federal income tax purposes holds shares of Capella common stock, the tax treatment of a partner in such partnership generally will depend on the status of the partner and the activities of the partnership. Any entity treated as a partnership for U.S. federal income tax purposes that holds shares of Capella common stock and any partners in such partnership should consult their own tax advisors regarding the tax consequences of the merger to them.

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ALL HOLDERS OF SHARES OF CAPELLA COMMON STOCK SHOULD CONSULT THEIR OWN TAX ADVISORS AS TO THE PARTICULAR TAX CONSEQUENCES TO THEM OF THE MERGER, INCLUDING THE APPLICABILITY AND EFFECT OF ANY U.S. FEDERAL, STATE, LOCAL, NON-U.S. AND OTHER TAX LAWS.

U.S. Federal Income Tax Consequences of the Merger to U.S. Holders of Capella Common Stock

It is a condition to Strayer's obligation to consummate the merger that Strayer receive an opinion from its tax counsel, dated as of the closing date, to the effect that the merger will qualify as a "reorganization" within the meaning of Section 368(a) of the Code. It is a condition to Capella's obligation to consummate the merger that Capella receive an opinion from its tax counsel, dated as of the closing date, to the effect that the merger will qualify as a "reorganization" within the meaning of Section 368(a) of the Code.

These opinions will be based on customary assumptions and representations from Strayer and Capella, as well as certain covenants and undertakings by Strayer, Capella and Merger Sub (collectively, the "tax opinion representations and assumptions"). If any of the tax opinion representations and assumptions is incorrect, incomplete or inaccurate or is violated, the validity of the opinions described above may be affected and the tax consequences of the merger could differ from those described in this joint proxy statement/prospectus.

An opinion of counsel represents counsel's best legal judgment but is not binding on the Internal Revenue Service (the "IRS") or any court, and there can be no certainty that the IRS will not challenge the conclusions reflected in the opinions or that a court would not sustain such a challenge. Neither Strayer nor Capella intends to obtain a ruling from the IRS with respect to the tax consequences of the merger. If the IRS were to successfully challenge the "reorganization" status of the merger, the tax consequences would differ from those described in this joint proxy statement/prospectus.

Accordingly, on the basis of the opinions described above:

- a U.S. Holder of shares of Capella common stock generally will not recognize any gain or loss upon the exchange of shares of Capella common stock for combined company shares in the merger, except with respect to cash received in lieu of fractional shares (as discussed below);

- a U.S. Holder of shares of Capella common stock will have a tax basis in the combined company shares received in the merger (including fractional shares deemed received and redeemed as described below) equal to the tax basis of the shares of Capella common stock surrendered in exchange therefor;

- a U.S. Holder of shares of Capella common stock will have a holding period for the combined company shares received in the merger (including fractional shares deemed received and redeemed as described below) that includes its holding period for its shares of Capella common stock surrendered in exchange therefor; and

- if a U.S. Holder of shares of Capella common stock acquired different blocks of shares of Capella common stock at different times or at different prices, the combined company shares received in the merger (including fractional shares deemed received and redeemed as described below) will be allocated pro rata to each block of shares of Capella common stock, and the basis and holding period of such combined company shares will be determined on a block-for-block approach depending on the basis and holding period of each block of shares of Capella common stock exchanged for such combined company shares.

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Cash in Lieu of Fractional Shares

A U.S. Holder that receives cash in lieu of a combined company fractional share generally will be treated as having received such fractional share and then as having received such cash in redemption of the fractional share. Gain or loss generally will be recognized based on the difference between the amount of cash received in lieu of the combined company fractional share and the portion of the U.S. Holder's aggregate adjusted tax basis in the combined company shares surrendered which is allocable to the combined company fractional share. Such gain or loss generally will be long-term capital gain or loss if the U.S. Holder's holding period for its shares of Capella common stock exceeds one (1) year at the effective time.

Information Reporting and Backup Withholding

A U.S. Holder (other than certain exempt U.S. Holders) that receives cash in lieu of a combined company fractional share may be subject to backup withholding (currently at a 28% rate) unless such U.S. Holder provides its correct taxpayer identification number and certifies as to exemption from backup withholding and otherwise complies with the applicable requirements of the backup withholding rules. A U.S. Holder that does not provide its correct taxpayer identification number may also be subject to penalties imposed by the IRS. Amounts withheld, if any, under the backup withholding rules are generally not an additional tax and may be refunded or credited against the U.S. Holder's federal income tax liability, provided the U.S. Holder timely furnishes the required information to the IRS.

THE MERGER AGREEMENT

The following is a summary of the material terms and conditions of the merger agreement. This summary may not contain all the information about the merger agreement that is important to you. This summary is qualified in its entirety by reference to the merger agreement attached as Annex A to, and incorporated by reference into, this joint proxy statement/prospectus. You are encouraged to read the merger agreement in its entirety because it is the legal document that governs the merger.

Explanatory Note Regarding the Merger Agreement and the Summary of the Merger Agreement

The merger agreement and the summary of its terms in this joint proxy statement/prospectus have been included to provide information about the terms and conditions of the merger agreement. The terms and information in the merger agreement are not intended to provide any other public disclosure of factual information about Capella, Strayer or any of their respective subsidiaries or affiliates. The representations, warranties, covenants and agreements contained in the merger agreement are made by Strayer, Capella and Merger Sub only for the purposes of the merger agreement and are qualified and subject to certain limitations and exceptions agreed to by Strayer, Capella and Merger Sub in connection with negotiating the terms of the merger agreement, including being qualified by reference to confidential disclosures. In particular, in your review of the representations and warranties contained in the merger agreement and described in this summary, it is important to bear in mind that the representations and warranties were made solely for the benefit of the parties to the merger agreement and were negotiated for the purpose of allocating contractual risk among the parties to the merger agreement rather than to establish matters as facts. The representations and warranties may also be subject to a contractual standard of materiality or material adverse effect different from those generally applicable to stockholders and reports and documents filed with the SEC including being qualified by reference to confidential disclosures. Moreover, information concerning the subject matter of the representations and warranties, which do not purport to be accurate as of the date of this joint proxy statement/prospectus, may have changed since the date of the merger agreement.

For the foregoing reasons, the representations, warranties, covenants and agreements and any descriptions of those provisions should not be read alone or relied upon as characterizations of the actual state of facts or condition of Strayer, Capella or any of their respective subsidiaries or affiliates. Instead, such provisions or descriptions should be read only in conjunction with the other information provided elsewhere in this joint proxy statement/prospectus or incorporated by reference into this joint proxy statement/prospectus.

Structure of the Merger

Pursuant to the merger agreement, Merger Sub will merge with and into Capella, with Capella surviving as a wholly owned subsidiary of Strayer.

Consummation and Effectiveness of the Merger

Unless the parties agree otherwise, the consummation of the merger will occur within three (3) business days after all conditions to the consummation of the merger described under "*Conditions to Consummation of the Merger*" have been satisfied or waived; provided that if such date would make it reasonably unlikely for the parties to either (a) comply with any laws applicable on a post-closing basis in order to obtain any Educational Consent or (b) satisfy conditions under applicable DOE regulations for continuing the effectiveness of any TPPPA, the consummation of the merger will take place on the first (1st) business day of the immediately following month, without regard to the outside date. The merger will be consummated and become effective at the time the articles of merger are duly filed with the Secretary of State of the State of Minnesota, or such later time as agreed to by Strayer and Capella and specified in the articles of merger.

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Post-Closing Governance

Pursuant to the merger agreement, effective at the effective time, unless otherwise agreed by Strayer and Capella in writing, the Strayer board of directors is required to take all necessary action to increase the size of the combined company board of directors to twelve (12) directors in order to appoint, as of the effective time, nine (9) directors to be designated by Strayer and three (3) directors to be designated by Capella (such designees of Capella, the "Additional Board Designees"). The Additional Board Designees will consist of (i) the chief executive officer of Capella as of the date of the merger agreement and (ii) two (2) additional designees (or, if item (i) is not applicable, three (3) designees) who are currently members of the Capella board of directors and recommended by the chief executive officer of Capella or the Capella board of directors (if item (i) is not applicable) to the Strayer board of directors and the nominating and corporate governance committee of the Strayer board of directors for approval, such approval not to be unreasonably withheld.

Effective at the effective time, unless otherwise agreed by Strayer and Capella in writing, Strayer will take all necessary action to cause (i) Robert S. Silberman to continue as executive chairman of the combined company board of directors, (ii) J. Kevin Gilligan to be appointed to act as the vice chairman of the combined company board of directors, (iii) Karl McDonnell to continue as President and Chief Executive Officer of the combined company, (iv) Steven L. Polacek to be appointed as the Chief Integration/Transition Officer of the combined company and (v) one Additional Board Designee to be appointed to the compensation committee of the combined company board of directors. The Strayer board of directors will nominate the Additional Board Designees for election at (i) if the effective time is prior to the 2018 annual meeting of stockholders, then the 2018 annual meeting of stockholders or (ii) if the effective time is after the 2018 annual meeting of stockholders, then the 2019 annual meeting of stockholders.

Merger Consideration

At the effective time, each Capella share issued and outstanding immediately prior to the effective time (other than shares held in treasury or held by Strayer, Capella or Merger Sub or any of their respective wholly owned subsidiaries) will be converted into the right to receive 0.875 of a newly-issued combined company share. No fractional combined company shares will be issued in the merger, and Capella shareholders will receive cash in lieu of fractional shares as part of the merger consideration, as specified in the merger agreement.

No Dissenters' Rights; No Appraisal Rights

Under Minnesota law and the Capella articles of incorporation, Capella shareholders will not be entitled to exercise any dissenters' rights in connection with the merger.

Under Maryland law, Strayer stockholders will not be entitled to appraisal rights in connection with the merger or the Strayer Required Proposals.

Procedures for Surrendering Capella Stock Certificates

Prior to the dissemination of this joint proxy statement/prospectus to the Capella shareholders and Strayer stockholders, Strayer has agreed to appoint its transfer agent to act as exchange agent to handle the exchange of Capella stock certificates or Capella book-entry shares for the merger consideration. At or prior to the effective time, Strayer will deposit the combined company shares comprising the aggregate merger consideration for the benefit of Capella shareholders. As promptly as practicable after the effective time (but in no event later than five (5) business days thereafter), Strayer will cause the exchange agent to mail to each holder of record of Capella shares at the effective time a letter of transmittal for the exchange and instructions explaining how to surrender Capella stock certificates or Capella book-entry shares to the exchange agent.

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Upon surrender of Capella stock certificates and Capella book-entry shares for cancellation to the exchange agent, and upon delivery of a properly completed letter of transmittal with respect to such Capella stock certificates or Capella book-entry shares, Capella shareholders will be entitled to receive the merger consideration for each Capella share formerly represented by such Capella stock certificates and for each Capella book-entry share.

Treatment of Capella Equity Awards

Capella Stock Options

Each Capella stock option that is outstanding immediately prior to the effective time (whether vested or unvested) and held by a continuing employee or director of Capella will automatically and without any action on the part of the holder thereof be assumed by Strayer and be converted into a Strayer stock option to acquire shares of Strayer common stock on the same terms and conditions as the Capella stock option to which it relates, equal to the product of the merger exchange ratio of 0.875 multiplied by the number of shares of Capella common stock subject to the option (rounded down to the nearest whole share), and will have an exercise price per share equal to the quotient obtained by dividing the exercise price per share of Capella common stock by the merger exchange ratio of 0.875 (rounded up to the nearest whole cent). Capella stock options that are outstanding and unexercised immediately prior to the consummation of the merger and held by former employees, directors or consultants of Capella will automatically and without any action on the part of the holder thereof be cancelled and converted into the right to receive a cash payment equal to the product of (i) the amount of merger consideration (if any) that the holder of such Capella stock option would have received had the Capella stock option been exercised immediately prior to the effective time for shares of Capella common stock (net of the applicable exercise price), and (ii) the VWAP of Strayer common stock for the ten (10) trading day period ending on the second to last trading day prior to the effective time. Capella stock options that are outstanding immediately prior to the effective time and held by current Capella directors who will not continue as members of the Strayer board of directors following effective time will automatically and without any action on the part of the holder thereof be cancelled and converted into the right to receive the merger consideration that the holder of such Capella stock option would have been entitled to receive if the Capella stock option had been exercised for shares of Capella common stock immediately prior to the effective time (net of the applicable exercise price).

Capella Restricted Stock Unit Awards

All Capella RSUs that are outstanding immediately prior to the consummation of the merger will be assumed by Strayer and will be converted into awards of Strayer RSUs and will continue to have, and will be subject to, the same terms and conditions as applied to the Capella RSUs immediately prior to the effective time, with appropriate adjustments in the number of shares of Strayer common stock subject to the Strayer RSU to reflect the merger exchange ratio. In addition, outstanding Capella RSUs granted to Capella directors under the Capella equity plans will become fully and immediately vested upon the effective time.

Conditions to Consummation of the Merger

Mutual Conditions to Consummation. The obligations of Capella, Strayer and Merger Sub to consummate the merger are subject to the satisfaction or waiver (to the extent permitted by applicable law) of the following conditions:

- approval of the Capella Merger Proposal by the holders of a majority of the outstanding shares of Capella common stock;
- approval of the Charter Amendment Proposal by the holders of a majority of the outstanding shares of Strayer common stock;

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approval of the Share Issuance Proposal by the holders of a majority of the votes cast at the Strayer special meeting;

approval for listing on NASDAQ of the combined company shares issuable to Capella shareholders in connection with the merger, subject to official notice of issuance;

absence of any applicable law or order being in effect which prohibits, restrains, enjoins, prevents, or makes illegal the consummation of the merger;

effectiveness of the Form S-4 under the Securities Act and not being the subject of any stop order;

the expiration or termination of any applicable waiting period under the HSR Act;

receipt of a DOE Preacquisition Review Notice by Capella which does not (i) indicate the existence of any impediment to the issuance by the DOE of a TPPPA with respect to any Title IV Capella school following the consummation of the merger that, individually or in the aggregate, would reasonably be expected to result in a combined company material adverse effect; or (ii) include any terms or conditions that, individually or in the aggregate, would reasonably be expected to result in a combined company material adverse effect;

(i) absence of any action taken by HLC or the MSCHE as applicable, to place Capella University or Strayer University, as applicable, on warning, probation, or show-cause status, in all cases where such status could reasonably be expected to result in the loss of the institutional accreditation status of Capella University or Strayer University, as applicable; (ii) absence of any action taken by any educational agency that could reasonably be expected to result in a loss of any Educational Approval held by a Capella school or a Strayer school, as applicable; and (iii) absence of any action taken by any educational agency that could reasonably expected to result in a change in the status of any Educational Approval held by a Capella school or Strayer school, as applicable, except, in the case of items (ii) and (iii), any action, in each case, that individually or in the aggregate, would not reasonably be expected to result in a combined company material adverse effect;

the Educational Consents required to be obtained prior to consummation of the merger by Capella and, if any, by Strayer shall have been effectuated or obtained, as applicable, without any terms or conditions that individually or in the aggregate, would reasonably be expected to result in a combined company material adverse effect; and

absence of any communication to Capella or Strayer from a representative of any educational agency (excluding the DOE) with respect to Educational Consents required to be obtained post-closing to the effect that such approval will not be granted; provided that this condition will not be satisfied if any such communication indicates that any such Educational Consents will be granted with terms or conditions that, individually or in the aggregate, would reasonably be expected to result in a combined company material adverse effect.

Certain conditions to consummation of the merger are qualified by "combined company material adverse effect." See " *Definition of 'Combined Company Material Adverse Effect'"* for the definition of combined company material adverse effect.

For the purposes of the merger agreement:

"Capella school" means any educational intuition or location owned or operated by Capella or any of its subsidiaries.

"DOE Preacquisition Review Notice" means a written notice from the DOE following the DOE's review of the applicable Preacquisition Review Application.

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"Educational Approval" means any approval issued or required to be issued by an educational agency to a Capella school or a Strayer school, as applicable, with respect to any aspect of such Capella school's operations or such Strayer school's operations, as applicable, subject to the oversight of such educational agency, including any such approval for such Capella school or such Strayer school, as applicable, to participate in any program of student financial assistance offered or administered by such educational agency, but excluding any approval issued to any Capella school's employees or any Strayer school's employees, as applicable, on an individual basis.

"Educational Consent" means any filing, notice, report, consent, registration, approval or authorization required to be made with or obtained from any governmental entity, including any educational agency, in connection with the execution, delivery and performance of the merger agreement or the consummation of the merger and the other transactions contemplated by the merger agreement, whether before or after the consummation of the merger, in order to maintain, continue or reinstate any Educational Approval held by any Capella school or any Strayer school.

"Strayer school" means any educational institution or location owned or operated by Strayer or any of its subsidiaries.

"Title IV Program" means the programs of federal student financial assistance administered pursuant to Title IV of the Higher Education Act of 1965, 20 U.S.C. § 1001 et seq., as amended, or successor statutes thereto, and its implementing regulations promulgated by the DOE.

"TPPPA" means a temporary provisional program participation agreement issued to a postsecondary institution, and to be countersigned by or on behalf of the secretary of the DOE evidencing such institution's continued eligibility for and participation in Title IV Programs on an interim basis following a change in ownership or control as determined by the DOE.

Additional Conditions to Consummation. In addition, the obligations of Strayer and Merger Sub on one hand, and Capella, on the other hand, to consummate the merger are subject to the satisfaction or waiver (to the extent permitted by applicable law) of the following conditions:

- the accuracy in all respects (subject only to *de minimis* inaccuracies) as of the date of the merger agreement and as of the closing date (or, in the case of representations and warranties that address matters only as of a particular date, as of such date) of certain representations and warranties made in the merger agreement by Capella or Strayer, as the case may be, regarding their respective capitalization;

- the accuracy in all material respects as of the date of the merger agreement and as of the closing date (or, in the case of representations and warranties that address matters only as of a particular date, as of such date) of certain representations and warranties made in the merger agreement by Capella or Strayer, as the case may be, regarding, among other matters, its (i) corporate organization, (ii) capitalization (other than as covered by the first bullet), (iii) authority; execution and delivery; and enforceability in connection with the merger agreement and the transactions contemplated therein, (iv) broker's fees, (v) opinion of financial advisor, and (vi) ownership of Strayer shares or Capella shares, as the case may be;

- the accuracy of all other representations and warranties made in the merger agreement by Capella or Strayer, as the case may be (disregarding all qualifications and exceptions contained in such representations and warranties relating to materiality or material adverse effect) as of the date of the merger agreement and as of the closing date (or, in the case of representations and warranties that address matters only as of a particular date, as of such date), except to the extent that any failures of such representations and warranties to be accurate, individually or in the aggregate, have not had and would not reasonable be expected to have, a material adverse effect on Capella or Strayer, as the case may be;

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performance or compliance with, as applicable, all of the material covenants and agreements required to be performed or complied with by Capella or Strayer, as the case may be, in all material respects and the receipt by Strayer or Capella, as the case may be, of a certificate from an executive officer of Capella or Strayer, as the case may be, certifying that this condition has been satisfied;

the absence since the date of the merger agreement and be continuing of any change, event, development, condition, occurrence or effect that has had, or would reasonable be expected to have, individually or in the aggregate, a material adverse effect on Capella or Strayer, as the case may be (see " *Definition of 'Material Adverse Effect''* for the definition of material adverse effect); and

the receipt by Strayer or Capella, as the case may be, of (i) an opinion from its tax counsel, dated as of the closing date, to the effect that the merger will qualify as a "reorganization" within the meaning of Section 368(a) of the Code and (ii) a copy of a reciprocal opinion received by Strayer or Capella from its tax counsel.

Representations and Warranties

The merger agreement contains a number of representations and warranties made by both Strayer and Capella that are subject in some cases to exceptions and qualifications (including exceptions that are not material to the party making the representations and warranties and its subsidiaries, taken as a whole, and exceptions that have not had, and would not reasonably be expected to have, individually or in the aggregate, a material adverse effect on the party making the representations and warranties). See " *Definition of 'Material Adverse Effect'*" for the definition of material adverse effect. The representations and warranties in the merger agreement relate to, among other things:

corporate organization;

capitalization;

authority; execution and delivery; enforceability;

no conflicts;

SEC documents; financial statements; undisclosed liabilities;

absence of certain changes or events;

information supplied;

legal proceedings;

compliance with laws;

permits;

employee benefit plans;

employee and labor matters;

environmental matters;

real property;

tax matters;

material contracts;

intellectual property;

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- educational regulatory matters;
- broker's fees;
- opinion of financial advisor;
- ownership of other party's equity interests;
- insurance; and
- no other representations or warranties.

Strayer also makes representations and warranties relating to, among other things, Merger Sub. The representations and warranties in the merger agreement do not survive the effective time. See " *Explanatory Note Regarding the Merger Agreement and the Summary of the Merger Agreement*."

Definition of "Material Adverse Effect"

Many of the representations and warranties in the merger agreement are qualified by "material adverse effect" on the party making such representations and warranties.

For purposes of the merger agreement, "material adverse effect" means, with respect to Strayer or Capella, as the case may be, any change, event, development, condition, occurrence or effect that is, or would reasonably be expected to (x) be, materially adverse to the business, condition (financial or otherwise), assets, liabilities or results of operations of that party and its subsidiaries, taken as a whole or (y) prevent or materially delay the consummation of the transactions contemplated by the merger agreement; provided, however, that, in the case of clause (x), none of the following shall be deemed in themselves, either alone or in combination, to constitute, and none of the following shall be taken into account in determining whether there has been or will be, a material adverse effect: (i) any changes resulting from general market, economic, financial, capital markets or political or regulatory conditions in the United States, (ii) any changes of law or GAAP (or, in each case, any authoritative interpretations thereof), (iii) any changes resulting from any act of terrorism, war, national or international calamity, or any worsening thereof, (iv) any changes generally affecting the industries in which that party and its subsidiaries conduct their businesses, including the post-secondary or proprietary education industry, (v) any changes resulting from the execution of the merger agreement or the announcement or the pendency of the merger, including any loss of employees or customers, any cancellation of or delay in customer orders or any disruption in or termination of (or loss of or other negative effect or change with respect to) customer, supplier, distributor or similar business relationships or partnerships resulting from the transactions contemplated by the merger agreement (provided that the exception in this clause (v) shall not apply to certain representations and warranties of the merger agreement), (vi) changes in that party's stock price or the trading volume of that party's stock or any change in the credit rating of that party (but not, in each case, the underlying cause of any such changes, unless such underlying cause would otherwise be excepted from this definition), (vii) any changes or effects resulting from any action required to be taken by the terms of the merger agreement, (viii) the failure to meet internal or analysts' expectations, projections or results of operations (but not, in each case, the underlying cause of any such changes, unless such underlying cause would otherwise be excepted from this definition) or (ix) any litigation relating to the transactions contemplated by the merger agreement; provided, that in the case of items (i), (ii), (iii) and (iv), if and only to the extent such changes do not have a disproportionate impact on that party and its subsidiaries, taken as a whole, as compared to other participants in the industries in which that party and its subsidiaries conduct their businesses.

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Definition of "Combined Company Material Adverse Effect"

Certain conditions to consummation of the merger are qualified by "combined company material adverse effect."

For purposes of the merger agreement "combined company material adverse effect" means any change, event, development, condition, occurrence or effect that is, or would reasonably be expected to be materially adverse to the business, condition (financial or otherwise), assets, liabilities or results of operations of Capella and Strayer and their respective subsidiaries, taken as a whole; provided, however that, none of the following shall be deemed in themselves, either alone or in combination, to constitute, and none of the following shall be taken into account in determining whether there has been or will be, a combined company material adverse effect: (i) any changes resulting from general market, economic, financial, capital markets or political or regulatory (other than educational regulatory) conditions in the United States, (ii) any changes of GAAP (or, in each case, any authoritative interpretations thereof) or (iii) any non-regulatory changes generally affecting the industries in which Capella or Strayer and their respective subsidiaries conduct their businesses, including the post-secondary or proprietary education industry; provided, that in the case of items (i), (ii) and (iii), if and only to the extent such changes do not have a disproportionate impact on Capella or Strayer and their respective subsidiaries, taken as a whole, as compared to other participants in the industries in which Capella or Strayer and their respective subsidiaries conduct their businesses.

Conduct of Business Pending the Merger

In general, except as may be required by applicable law, stock exchange requirement or any educational agency and except as set forth in the confidential disclosure letter delivered to the other party concurrently with the execution of the merger agreement of each party or as otherwise expressly contemplated by the merger agreement, unless the other party otherwise consents in writing (which consent may not be unreasonably withheld, conditioned or delayed), Strayer, Capella and their respective subsidiaries are required to (i) conduct their operations only in the ordinary course of business consistent with past practice, (ii) use their reasonable best efforts to keep available the services of their respective current officers, employees and consultants and to preserve the goodwill and current relationships with their respective students, customers, suppliers and other persons with which they have material business relations, and (iii) use their reasonable best efforts to preserve intact their respective business organization (including their respective material assets and properties) and comply with all applicable laws.

Without limiting the foregoing, except as may be required by applicable law, stock exchange requirement or any educational agency, set forth in Strayer's or Capella's confidential disclosure letter or as otherwise expressly contemplated in the merger agreement, each of Strayer and Capella and each of their respective subsidiaries is not permitted to, between the date of the merger agreement and the effective time, take any of the following actions without the prior written consent of Capella, in the case of actions taken by Strayer, or Strayer, in the case of actions taken by Capella (which consent may not be unreasonably withheld, conditioned or delayed):

- amend or otherwise change, or authorize or propose to amend or otherwise change its charter or bylaws or equivalent organizational documents;

- issue, sell, pledge, dispose of, grant, transfer or encumber, or authorize the issuance, sale, pledge, disposition, grant, transfer or encumbrance of, any shares of capital stock of, or other equity interests in, Strayer or Capella, as the case may be, or any of Strayer's or Capella's subsidiaries, as the case may be, of any class, or securities convertible into, or exchangeable or exercisable for any shares of such capital stock or other equity interests, or any options, warrants or other rights, agreements, arrangements or commitments of any kind to acquire any shares of such capital stock or other equity interests or such convertible or exchangeable securities, or any other ownership interest (including any such interest represented by contract right), of Strayer or Capella, as the case may be, or any of Strayer's or Capella's subsidiaries, as the case may be, subject to certain exceptions;

sell, pledge, dispose of, transfer, lease, license, guarantee or encumber, or authorize the sale, pledge, disposition, transfer, lease, license, guarantee or encumbrance of, any property or assets of Strayer or Capella, as the case may be, or any of Strayer's or Capella's subsidiaries, as the case may be, with value in excess of $1,000,000 annually, subject to certain exceptions;

sell, assign, pledge or otherwise encumber, transfer, license, abandon, place in the public domain, permit to lapse or otherwise dispose of any of material intellectual property of Strayer or Capella, as the case may be, or any of Strayer's or Capella's subsidiaries, as the case may be, subject to certain exceptions;

(i) declare, set aside, make or pay any dividend or other distribution (whether payable in cash, stock, property or a combination thereof) with respect to any of its capital stock or other equity interests (other than dividends paid by a wholly owned subsidiary of Strayer to Strayer or another wholly owned subsidiary of Strayer or dividends paid by a wholly owned subsidiary of Capella to Capella or another wholly owned subsidiary of Capella, as the case may be) or (ii) enter into any agreement with respect to the voting or registration of its capital stock or other equity interests;

reclassify, combine, split, subdivide or amend the terms of, or redeem, purchase or otherwise acquire, directly or indirectly, any of its capital stock or other equity interests;

merge or consolidate Strayer or Capella, as the case may be, or any of Strayer's or Capella's subsidiaries, as the case may be, with any person or adopt a plan of complete or partial liquidation or resolutions providing for a complete or partial liquidation, dissolution, restructuring, recapitalization or other reorganization of Strayer or Capella, as the case may be, or any of Strayer's or Capella's subsidiaries, as the case may be, subject to certain exceptions;

acquire (including by merger, consolidation, or acquisition of stock or assets) any interest in any person or any assets thereof, in each case, with value in excess of $2,500,000 or in a transaction that would reasonably be expected to materially delay, impede or prevent the consummation of the transactions contemplated by the merger agreement in accordance with the terms of the merger agreement;

repurchase, repay, refinance or incur any indebtedness for borrowed money, subject to certain exceptions;

make any loans, advances or capital contributions to, or investments in, any other person (other than any wholly owned subsidiary of Strayer or Capella, as the case may be) in excess of $2,500,000 in the aggregate, other than ordinary course advances to employees for reasonable and documented business expenses in accordance with Strayer policies or Capella policies, as the case may be;

terminate, cancel, renew, or request or agree to any material change in or waiver under any material contract of Strayer or Capella, as the case may be, or any of Strayer's or Capella's subsidiaries, as the case may be, or enter into or amend any contract that, if existing on the date of the merger agreement, would be a material contract of Strayer or Capella, as the case may be, or any of Strayer's or Capella's subsidiaries, as the case may be, or waive, release, assign or otherwise forego any material right or claim of Strayer or Capella, as the case may be, or any of Strayer's or Capella's subsidiaries, as the case may be, under any material contract of Strayer or Capella, as the case may be, or any of Strayer's or Capella's subsidiaries, as the case may be, in each case, other than in the ordinary course of business consistent with past practice;

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make or authorize any capital expenditure in excess of Strayer's or Capella's capital expenditure budget, as the case may be, as disclosed to Capella or Strayer, as the case may be, prior to the date of the merger agreement, other than capital expenditures that are not, when added to all other capital expenditures made on behalf of all of Strayer or Capella, as the case may be, or any of Strayer's or Capella's subsidiaries, as the case may be, since the date of the merger agreement but not provided for in Strayer's or Capella's capital expenditure budget, as the case may be, as disclosed to Capella or Strayer, as the case may be, prior to the date of the merger agreement, in excess of $2,500,000;

except in the ordinary course of business consistent with past practice or to the extent required by (i) applicable law or (ii) the existing terms of any Strayer employee benefit plan or Capella employee benefit plan, as the case may be, as disclosed in Strayer's or Capella's confidential disclosure letter, as the case may be: (A) increase the compensation or benefits payable or to become payable to its directors, officers, individual independent contractors or employees; (B) grant any rights to severance or termination pay or bonus payments to, or enter into any employment or severance agreement with, any director, officer or employee of Strayer or Capella, as the case may be, or any of Strayer's or Capella's subsidiaries, as the case may be; (C) establish, adopt, enter into or amend any (i) collective bargaining agreement or other contract with any labor union or labor organization, or (ii) Strayer employee benefit plan or Capella employee benefit plan, as the case may be, or similar plan, agreement, trust, fund, policy or arrangement for the benefit of any director, officer or employee, except to the extent required by the terms of a collective bargaining agreement in existence on the date of the merger agreement; (D) take any action to amend or waive any performance or vesting criteria under any Strayer employee benefit plan or Capella employee benefit plan, as the case may be; (E) hire any employee with an annual base salary that exceeds $250,000 or hire any officer; (F) engage in any actions that could implicate the WARN Act; provided, however, that, in each case, the grant of Strayer equity awards or Capella equity awards, as the case may be, must be granted in accordance with the terms of the merger agreement and provided further that the grant of cash bonuses shall not exceed per calendar year starting on January 1, 2018, aggregate dollar amounts and individual allocations consistent with past practice, or (G) in the case of Capella, take any action that could cause any participant in the Capella Senior Executive Severance Plan or the Capella Executive Severance Plan (collectively, the "Cardinal Severance Plans") to terminate such individual's employment for "Good Reason" (within the meaning of the Cardinal Severance Plans);

forgive any loans to directors, officers or employees of Strayer or Capella, as the case may be, or any of Strayer's or Capella's subsidiaries, as the case may be;

waive, release, pay, discharge or satisfy any claims, liabilities or obligations (absolute, accrued, contingent or otherwise) with value in excess of $1,000,000, except in the ordinary course of business consistent with past practice and in accordance with their terms;

make any material change in accounting policies, practices, principles, methods or procedures, other than as required by GAAP (or definitive or binding interpretations thereof) or by a governmental entity or educational agency;

waive, release, assign, settle or compromise any claims or rights with value in excess of $1,000,000 held by Strayer or Capella, as the case may be, or any of Strayer's or Capella's subsidiaries, as the case may be;

compromise, settle or agree to settle any proceeding by or before any governmental entity or educational agency other than (i) litigation relating to the transactions contemplated by the merger agreement (which is governed by elsewhere in the merger agreement) and (ii) compromises, settlements or agreements in the ordinary course of business consistent with

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past practice that involve only the payment of monetary damages not in excess of $500,000 individually or $1,000,000 in the aggregate, in any case without the imposition of equitable relief on, or the admission of wrongdoing by, Strayer or Capella, as the case may be, or any of Strayer's or Capella's subsidiaries, as the case may be;

make any material tax election that is not consistent with past practices and procedures, change or revoke any material tax election, change any tax accounting period for purposes of a material tax or material method of tax accounting, file any material amended tax return, settle or compromise any audit or proceeding relating to a material amount of taxes, except in the ordinary course of business, agree to an extension or waiver of the statute of limitations with respect to a material amount of taxes, enter into any "closing agreement" within the meaning of Section 7121 of the Code (or any similar provision of state, local, or non-U.S. law) with respect to any material tax, or surrender any right to claim a material tax refund;

convene any annual or special meeting (or any postponement or adjournment thereof) of the Strayer stockholders or Capella shareholders, as the case may be, other than the Strayer special meeting or the Capella special meeting, as the case may be, contemplated by this joint proxy statement/prospectus and the 2018 annual meeting of stockholders or shareholders, as the case may be (only if such 2018 annual meeting is not otherwise combined with the Strayer special meeting or the Capella special meeting, as the case may be, contemplated by this joint proxy statement/prospectus);

enter into any new line of business outside of the post-secondary or proprietary education industry;

fail to use reasonable efforts to maintain existing material insurance policies or comparable replacement policies to the extent available for a reasonable cost; or

authorize or enter into any contract to do any of the foregoing or propose or otherwise make any commitment to do any of the foregoing.

Obligations to Call Stockholders' Meetings

Each of Strayer and Capella has agreed to, promptly following the date on which the Form S-4 has been filed with the SEC, establish a record date for, and, as soon as practicable following the effectiveness of the Form S-4, duly call and give notice of and convene and hold a meeting of its stockholders for the purpose of which Strayer will seek the vote of its stockholders required to approve the amendment and restatement of the Strayer charter and the issuance of Strayer shares to be issued in the merger and Capella will seek the vote of its shareholders required to approve the merger agreement.

Subject to certain limitations, each party may postpone or adjourn the meeting of its stockholders (i) with the prior written consent of the other party; (ii) if a quorum has not been established; (iii) to allow reasonable additional time for the filing and mailing of any supplemental or amended disclosure which its respective board of directors has determined in good faith after consultation with outside counsel is necessary under applicable law and for such supplemental or amended disclosure to be disseminated and reviewed by its stockholders prior to the meeting of its stockholders; (iv) to allow reasonable additional time to solicit additional proxies, if and to the extent the required vote of its stockholders in connection with the merger at such meeting would not otherwise be obtained; or (v) if required by law.

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Obligations to Recommend the Approval of the Merger Agreement and the Approval of the Strayer Charter Amendment and the Strayer Share Issuance

As discussed under "*The Capella Special Meeting*," Capella's board of directors recommends that Capella shareholders vote "**FOR**" the Capella Merger Proposal ("Capella recommendation"). Capella's board of directors, however, may effect a Capella Adverse Recommendation Change within the meaning of items (x), (y) and (z)(2) of the definition thereof, in each case under specified circumstances as discussed under " *No Solicitation*."

Similarly, as discussed under "*The Strayer Special Meeting*," Strayer's board of directors recommends that Strayer stockholders vote "**FOR**" the Share Issuance Proposal and the Charter Amendment Proposal ("Strayer recommendation"). Strayer's board of directors, however, may effect a Strayer Adverse Recommendation Change within the meaning of items (x), (y) and (z)(2) of the definition thereof, in each case under specified circumstances as discussed under " *No Solicitation*."

No Solicitation

Under the terms of the merger agreement, subject to certain exceptions described below, each of Strayer and Capella has agreed, from the date of the merger agreement until the earlier of the effective time or the date, if any, of the termination of the merger agreement in accordance with the terms of the merger agreement, it shall not, and shall cause its respective subsidiaries and representatives not to, directly or indirectly:

- solicit, initiate or knowingly encourage or induce (including by way of furnishing information which has not been previously publicly disseminated), or take any other action that could reasonably be expected to facilitate, any inquiries or the making of any proposal which constitutes, or could reasonably be expected to lead to, any Competing Proposal; or

- engage in any discussions or negotiations regarding any Competing Proposal.

Notwithstanding the foregoing, if, prior to obtaining the Strayer stockholder approval (in the case of Strayer) or the Capella shareholder approval (in the case of Capella) and following the receipt of a bona fide written unsolicited Competing Proposal made after the date of the merger agreement and the Strayer board of directors or the Capella board of directors, as applicable, determines in good faith (after receiving advice of its financial advisor and of its outside legal counsel) is or could reasonably be expected to lead to a Superior Proposal and that was not, directly or indirectly, solicited, initiated or knowingly encouraged in violation of the non-solicitation obligations under the merger agreement, the Strayer board of directors or the Capella board of directors, as applicable, determines in good faith, after consultation with outside legal counsel, that a failure to take action with respect to such Competing Proposal, as applicable, would be inconsistent with the directors' duties to Strayer under applicable law (in the case of the Strayer board of directors) or the directors' fiduciary duties to Capella's shareholders under applicable law (in the case of the Capella board of directors), then Strayer or Capella may, in response to such Competing Proposal, as applicable, and subject to compliance with the non-solicitation obligations under the merger agreement, (A) furnish information with respect to Strayer or Capella, as applicable, to the person making such Competing Proposal pursuant to an acceptable confidentiality agreement, and (B) engage in discussions or negotiations with such person regarding such Competing Proposal.

Each of Capella and Strayer has agreed that it shall not, and shall cause its respective subsidiaries and representatives not to, from and after the date of the merger agreement until the earlier of the effective time or the date, if any, on which the merger agreement is terminated pursuant to the terms of the merger agreement, directly or indirectly:

- approve, endorse, recommend or enter into, or propose to approve, endorse, recommend or enter into, any letter of intent, memorandum of understanding, agreement in principle,

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acquisition agreement, merger agreement or similar definitive agreement (other than an acceptable confidentiality agreement) with respect to any Competing Proposal or any proposal or offer that would reasonably be expected to lead to any Competing Proposal (an "Alternative Acquisition Agreement");

take any action to make the provisions of any takeover statute inapplicable to any transactions contemplated by a Competing Proposal;

terminate, amend, release, modify or knowingly fail to enforce any provision of, or grant any permission, waiver or request under, any standstill, confidentiality or similar agreement entered into by the applicable party in respect of or in contemplation of a Competing Proposal (other than to the extent the Capella board or the Strayer board, as applicable, determines in good faith after consultation with its outside legal counsel, that failure to take any of such actions would be inconsistent with the directors' duties under applicable law); or

propose to do any of the foregoing.

Notwithstanding the foregoing, prior to obtaining the Strayer stockholder approval (in the case of Strayer) or the Capella shareholder approval (in the case of Capella) and following the receipt of a bona fide written Competing Proposal made after the date of the merger agreement that was not, directly or indirectly, solicited, initiated or knowingly encouraged in violation of the non-solicitation obligations under the merger agreement, the Strayer board or the Capella board, as applicable, may effect a Strayer Adverse Recommendation Change within the meaning of items (x), (y) and (z)(2) of the definition thereof or a Capella Adverse Recommendation Change within the meaning of items (x), (y) and (z)(2) of the definition thereof, as applicable or terminate the merger agreement to enter into an Alternative Acquisition Agreement pursuant to the terms of the merger agreement, but if and only if:

the Strayer board of directors or the Capella board of directors, as applicable, concludes in good faith, after consultation with Strayer's or Capella's outside financial advisors and outside legal counsel, that such Competing Proposal constitutes a Superior Proposal;

the Capella board of directors or the Strayer board of directors, as applicable, provides the other party five (5) business days prior written notice of its intention to take such action (a "Competing Proposal Notice");

during the five (5) business days following such written notice (the "Negotiation Period"), if requested by the other party, the board of directors of the applicable party proposing to effect the recommendation change and its representatives have negotiated in good faith with the other party regarding any revisions to the terms of the transactions proposed by the other party in response to such Competing Proposal; and

at the end of the Negotiation Period, the Strayer board of directors or Capella board of directors, as applicable, concludes in good faith, after consultation with Strayer's or Capella's outside legal counsel and financial advisors (and taking into account any adjustment or modification of the terms of the merger agreement to which the other party has agreed in writing to make to the terms of the transactions), that the Competing Proposal continues to be a Superior Proposal and, after consultation with Strayer's or Capella's outside legal counsel, as applicable, that the failure to make such a Strayer Adverse Recommendation Change or Capella Adverse Recommendation Change, as applicable, would be inconsistent with the exercise, in the case of the Strayer board of directors, of the directors' duties to Strayer under applicable law or, in the case of the Capella board of directors, of the directors' fiduciary duties to the shareholders of Capella under applicable law.

Any material amendment or modification to any Competing Proposal shall require a new Competing Proposal Notice and the Negotiation Period shall be extended by an additional three (3) business days from the date of receipt of such new Competing Proposal Notice.

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Further, at any time prior to obtaining the Capella shareholder approval or the Strayer stockholder approval, as applicable, the Capella board or the Strayer board, as applicable, may make a Capella Adverse Recommendation Change or a Strayer Adverse Recommendation Change, as applicable, if (i) such board determines that an Intervening Event has occurred and is continuing and (ii) such board determines in good faith (after consultation with outside counsel) that the failure to make a Capella Adverse Recommendation Change or a Strayer Adverse Recommendation Change, as applicable, in response to such Intervening Event would be inconsistent with the directors' duties to Strayer under applicable law (in the case of the Strayer board) or the directors' fiduciary duties to its shareholders under applicable law (in the case of the Capella board), as applicable; *provided* that (x) the Capella board or the Strayer board, as applicable, has given the other party at least five (5) business days prior written notice of its intention to take such action and specifying in reasonable detail the circumstances related to such determination and (y) prior to effecting a Capella Adverse Recommendation Change or a Strayer Adverse Recommendation Change, as applicable, the applicable party has negotiated, and has caused its representatives to negotiate, in good faith with the other party during such notice period to the extent such other party wishes to negotiate, to enable such party to revise the terms of the merger agreement, such that the failure to make such a Capella Adverse Recommendation Change or a Strayer Adverse Recommendation Change, as applicable, would not be inconsistent with the directors' duties under applicable law.

Any failure of Capella's or Strayer's respective subsidiaries or its and their respective representatives to fully comply with the non-solicitation obligations under the merger agreement shall be deemed a breach of the non-solicitation obligations under the merger agreement by Capella or Strayer, as applicable.

For purposes of the merger agreement:

"Capella Adverse Recommendation Change" means, with respect to the Capella board, (x) the withholding, withdrawal, modification, qualification or amendment, or proposal to publicly withhold, withdraw, modify, qualify or amend, in a manner adverse to Strayer, the Capella recommendation, (y) making, or permitting any director or executive officer to make, any public statement in connection with the Capella special meeting that would reasonably be expected to have the same effect or (z)(1) approving, determining to be advisable, or recommending, or proposing publicly to approve, determine to be advisable, or recommend, any Competing Proposal or failing to publicly and without qualification recommend against any Competing Proposal or (2) failing to reaffirm the Capella recommendation, in either case within ten (10) business days after such Competing Proposal is made public or after any reasonable, written request by Strayer to do so.

"Competing Proposal" shall mean, other than the transactions contemplated under the merger agreement, any proposal, offer or inquiry from a third party relating to (A) a merger, reorganization, sale or license of assets, share exchange, tender offer, consolidation, business combination, recapitalization, dissolution, liquidation, joint venture or similar transaction involving Capella or Strayer, as applicable, or any of their respective subsidiaries; (B) the acquisition (whether by merger, consolidation, equity investment, joint venture or otherwise) by any person of twenty percent (20%) or more of the consolidated assets of Capella or Strayer, as applicable, and their respective subsidiaries, as determined on a book-value or fair-market-value basis; (C) the purchase or acquisition, in any manner, directly or indirectly, by any person of twenty percent (20%) or more of the issued and outstanding shares of the Capella common stock or the Strayer common stock, as applicable, or any other equity interests in Capella or Strayer, as applicable, (D) any purchase, acquisition, tender offer or exchange offer that, if consummated, would result in any person or "group" (as defined pursuant to Section 13(d) of the Exchange Act) beneficially owning twenty percent (20%) or more of the shares of Capella common stock or Strayer common stock, as applicable or any other equity interests of Capella, Strayer or any of their respective subsidiaries; or (E) any combination of the foregoing.

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"Intervening Event" means any positive material event, development or change in circumstances that first occurs, arises or becomes known to Capella or Strayer, as applicable, or its respective board of directors after the date of the merger agreement, to the extent that such event, development or change in circumstances was not known or reasonably foreseeable as of the date of the merger agreement (or if known or reasonably foreseeable, the probability of magnitude of consequences of which were not known or reasonably foreseeable); provided, however, that in no event shall the following events, developments or changes in circumstances constitute an Intervening Event: (1) the receipt, existence or terms of a Competing Proposal or any matter relating thereto or consequence thereof; (2) any change in the price, or change in trading volume, of Capella common stock or Strayer common stock, as applicable (provided, however, that the exception set forth in this item (2) shall not apply to the underlying causes giving rise to or contributing to such change or prevent any of such underlying causes from being taken into account in determining whether an Intervening Event has occurred); (3) meeting or exceeding internal or analysts' expectations, projections or results of operations (provided, however, that the exception set forth in this clause (3) shall not apply to the underlying causes giving rise to or contributing to such circumstances or prevent any of such underlying causes from being taken into account in determining whether an Intervening Event has occurred); and (4) any action taken by either party pursuant to and in compliance with the affirmative covenants set forth in the merger agreement, and the consequences of any such action.

"Strayer Adverse Recommendation Change" means, with respect to the Strayer board, (x) the withholding, withdrawal, modification, qualification or amendment, or proposal to publicly withhold, withdraw, modify, qualify or amend, in a manner adverse to Capella, the Strayer recommendation, (y) making, or permitting any director or executive officer to make, any public statement in connection with the Strayer special meeting that would reasonably be expected to have the same effect or (z)(1) approving, determining to be advisable, or recommending, or proposing publicly to approve, determine to be advisable, or recommend, any Competing Proposal or failing to publicly and without qualification recommend against any Competing Proposal or (2) failing to reaffirm the Strayer recommendation, in either case within ten (10) business days after such Competing Proposal is made public or after any reasonable, written request by Capella to do so.

"Superior Proposal" means a bona fide written Competing Proposal (except the references therein to "20%" shall be replaced by "80%") made by a third party which was not solicited by Capella or Strayer or any of their respective representatives and which, in the good faith judgment of the Capella board of directors or the Strayer board of directors, as applicable, and after consultation with its outside financial and legal advisors, taking into account the various legal, financial and regulatory aspects of the Competing Proposal, including the financing terms thereof, and the third party making such Competing Proposal in addition to such other factors as the Capella board of directors or the Strayer board of directors, as applicable, considers to be appropriate, (A) if accepted, is reasonably likely to be consummated, and (B) if consummated, would result in a transaction that is more favorable to Capella shareholders or Strayer stockholders, as applicable, from a financial point of view, than the merger and the other transactions contemplated in the merger agreement (after giving effect to all adjustments or modifications to the terms thereof which may be agreed in writing to be made by the other party (including pursuant to non-solicitation obligations under the merger agreement)) and (C) if a cash transaction (in whole or in part), financing for which is then fully committed or reasonably determined to be available.

Appropriate Action Covenant

Upon the terms and subject to the conditions set forth in the merger agreement, each of the parties agrees to cooperate and use its reasonable best efforts to take, or cause to be taken, all actions that are necessary, proper or advisable under the merger agreement and applicable law to consummate and make effective the merger and the other transactions contemplated by the merger agreement as

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promptly as practicable, including using reasonable best efforts to accomplish the following: (i) obtain all necessary consents, approvals or waivers from third parties, including under any contract to which Capella or Strayer or any of their respective subsidiaries is party or by which such person or any of their respective properties or assets may be bound, (ii) obtain all necessary actions or non-actions, waivers, consents, approvals, orders and authorizations from governmental entities (including, without limitation, those in connection with the HSR Act), make all necessary registrations, declarations and filings with and take all steps as may be necessary to obtain an approval or waiver from, or to avoid any proceeding by, any governmental entity or educational agency (including, the pre-closing Educational Consents required to be obtained by Capella and the pre-closing Educational Consents required to be obtained by Strayer (if any) and in connection with the HSR Act), and (iii) execute and deliver any additional instruments necessary to consummate the transactions contemplated by the merger agreement and fully carry out the purposes of the merger agreement; *provided* that in no event shall the "reasonable best efforts" of any party include the obligation to defend or prosecute any suit, arbitration or other adversarial proceeding (in each case, whether judicial, arbitral or administrative) by or against any governmental entity or any educational agency. Each of the parties shall furnish to each other party such necessary information and reasonable assistance as such other party may reasonably request in connection with the foregoing.

Indemnification Covenant

From and after the effective time, Strayer shall, and shall cause the surviving corporation to, indemnify, defend and hold harmless each present and former director and officer of Capella, Strayer and any of their respective subsidiaries (each, an "indemnitee" and, collectively, the "indemnitees") against any costs or expenses (including reasonable attorneys' fees), judgments, settlements, fines, losses, claims, damages or liabilities incurred in connection with any proceeding or investigation, whether civil, criminal, administrative or investigative, arising out of or pertaining to matters existing or occurring at or prior to the effective time, including in connection with the merger agreement or the transactions contemplated by the merger agreement.

For a period of no less than six (6) years from the effective time, Strayer shall cause the surviving corporation to, and the surviving corporation shall, maintain in effect the exculpation, indemnification and advancement of expenses provisions of the organizational documents of Capella, Strayer or any of their respective subsidiaries in effect as of the date of the merger agreement, and shall not amend, repeal or otherwise modify any such provisions in any manner that would adversely affect the rights thereunder of any individuals who immediately before the effective time were current or former directors or officers of Capella, Strayer or any of their respective subsidiaries.

Employee Matters

To the extent permitted by applicable laws, Strayer shall credit each employee of Strayer, Capella or any of their respective subsidiaries as of the consummation of the merger who continues employment with Strayer or the surviving corporation following the closing date (each a "continuing employee") with his or her years of service with Strayer, Capella or any of their respective subsidiaries and predecessor entities, under any employee benefit plans, programs and arrangements in which such continuing employee participates following the consummation of the merger (the "post-closing plan"), to the same extent as such continuing employee was entitled immediately prior to the consummation of the merger to credit for such service under any similar Strayer benefit plan or Capella benefit plan, for purposes of eligibility for participation and vesting (but not accrual of benefits, other than for purposes of determining the level of vacation, travel and/or severance benefits), except to the extent such recognition would result in a duplication of benefits.

In addition, for purposes of each post-closing plan providing medical, dental, pharmaceutical, vision and/or other health benefits to any continuing employee and his or her dependents, Strayer shall

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(i) cause all waiting periods, pre-existing condition exclusions, evidence of insurability requirements and actively-at-work requirements of such post-closing plan to be waived for such continuing employee and his or her covered dependents, to the extent any such waiting periods, pre-existing condition exclusions, evidence of insurability requirements and actively-at-work requirements were waived or were inapplicable under the comparable Strayer benefit plan or Capella benefit plan, (ii) fully credit each continuing employee with all deductible payments, co-payments and other out-of-pocket expenses incurred by such continuing employee and his or her covered dependents under the medical, dental, pharmaceutical or vision benefit plans of Strayer or Capella (or their respective subsidiaries), as applicable, prior to the consummation of the merger during the plan year in which the consummation of the merger occurs for the purpose of determining the extent to which such continuing employee has satisfied the deductible, co-payments, or maximum out-of-pocket requirements applicable to such continuing employee and his or her covered dependents for such plan year under any pre-closing plan providing medical, dental, pharmaceutical, vision or health benefits, as if such amounts had been paid in accordance with such plan, and (iii) credit the accounts of such continuing employees under any post-closing plan that is a flexible spending plan with any unused balance in the account of such continuing employee under the applicable Strayer benefit plan or Capella benefit plan.

Without limiting the generality of the foregoing, each continuing employee who satisfies the eligibility requirements of a Strayer benefit plan or a Capella benefit plan that is a 401(k) plan shall be eligible to participate in a 401(k) plan maintained by Strayer or the surviving corporation following the consummation of the merger (each a "post-closing 401(k) plan") and shall be credited with eligibility service and vesting service for all periods of service with Strayer and Capella, and their respective subsidiaries to the extent so credited with such service under the applicable 401(k) plan as of the closing date. Additionally, in the event Strayer or any of its subsidiaries freezes a 401(k) plan after the closing date, each continuing employee who participates in such frozen plan shall, following such action, become eligible to participate in a post-closing 401(k) plan.

Other Agreements

The merger agreement contains certain other covenants and agreements, including covenants and agreements requiring, among other things, and subject to certain exceptions and qualifications described in the merger agreement:

- cooperation between Capella and Strayer in the preparation of this joint proxy statement/prospectus;
- confidentiality and access by each party to certain information about the other party during the period prior to the effective time;
- cooperation between Capella and Strayer in the defense or settlement of any stockholder litigation relating to the merger;
- cooperation between Capella and Strayer in connection with public announcements;
- giving prompt notice to the other party upon the occurrence of certain events;
- taking all steps as may be required to cause each individual who is subject to reporting requirements under Section 16(a) of the Exchange Act as a result of the transactions contemplated by the merger agreement to be exempt under Rule 16b-3 of the Exchange Act;
- the use of each party's reasonable best efforts to cause the merger to qualify as a "reorganization" within the meaning of Section 368(a) of the Code; and
- furnishing to the other party interim financial reports promptly after the end of each week or at the end of each month, as applicable.

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Termination of the Merger Agreement

The merger agreement may be terminated at any time before the effective time in any of the following ways:

- by mutual written consent of Capella and Strayer; or
- by either Capella or Strayer:
  - if any law or final and non-appealable order shall have been promulgated, entered, enforced, enacted or issued or shall be deemed to be applicable to the merger by any governmental entity of competent jurisdiction which permanently prohibits, restrains or makes illegal the consummation of the merger; provided that the right to terminate the merger agreement pursuant to this paragraph will not be available to any party whose failure to perform any of its obligations under the merger agreement is the primary cause of, or resulted in, the enactment or issuance of any such law or order;
  - if the transactions contemplated by the merger agreement have not have been consummated by July 31, 2018; provided, that in the event that, as of July 31, 2018, all conditions to consummation of the merger set forth in the merger agreement have been satisfied or waived (other than such conditions that by their terms are satisfied at the consummation of the merger, which shall be reasonably capable of being satisfied as of such date) other than the conditions relating to absence of legal restraints (solely with respect to the matters relating to regulatory approvals) and regulatory approvals, the termination date shall be automatically extended to March 31, 2019 (such date, including any such permitted extensions thereof, the "outside date") and provided, further, that the right to terminate the merger agreement pursuant to this paragraph shall not be available to any party whose failure to perform any of its obligations under the merger agreement is the primary cause of, or resulted in, the failure of the transactions contemplated by the merger agreement to be consummated by such time;
  - if the Capella shareholder approval shall not have been obtained upon a vote at the Capella special meeting; provided that the right to terminate the merger agreement pursuant to this paragraph shall not be available to Capella if Capella's failure to perform any of its obligations under the merger agreement is the primary cause of, or resulted in, the failure to obtain the Capella shareholder approval; or
  - if the Strayer stockholder approval shall not have been obtained upon a vote at the Strayer special meeting; provided that the right to terminate the merger agreement pursuant to this paragraph shall not be available to Strayer if Strayer's failure to perform any of its obligations under the merger agreement is the primary cause of, or resulted in, the failure to obtain the Strayer stockholder approval;
- by Strayer:
  - if Capella shall have breached or failed to perform any of its representations, warranties or covenants contained in the merger agreement, which breach or failure to perform (A) is incapable of being cured by Capella prior to the outside date or otherwise is not cured by the earlier of (x) twenty (20) business days following written notice to Capella by Strayer of such breach or (y) the business day prior to the outside date and (B) would result in a failure of the applicable closing condition relating to accuracy of its representations and warranties or performance of its covenants to be satisfied;
  - if Capella shall have breached in any material respect any of its non-solicitation obligations under the merger agreement;

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- if the Capella board of directors has effected a Capella Adverse Recommendation Change; or

- if, prior to the Strayer stockholder approval, the Strayer board determines to enter into a definitive written Alternative Acquisition Agreement with respect to a Superior Proposal, but only if (x) Strayer is permitted to terminate the merger agreement and accept such Superior Proposal, and (y) immediately prior to or substantially concurrently with such termination, Strayer pays a termination fee to Capella;

by Capella:

- if Strayer shall have breached or failed to perform any of its representations, warranties or covenants contained in the merger agreement, which breach or failure to perform (A) is incapable of being cured by Strayer prior to the outside date or otherwise is not cured by the earlier of (x) twenty (20) business days following written notice to Strayer by Capella of such breach or (y) the business day prior to the outside date and (B) would result in a failure of the applicable closing condition relating to accuracy of its representations and warranties or performance of its covenants to be satisfied;

- if Strayer shall have breached in any material respect any of its non-solicitation obligations under the merger agreement;

- if the Strayer board of directors has effected a Strayer Adverse Recommendation Change; or

- if, prior to the Capella shareholder approval, the Capella board of directors determines to enter into a definitive written Alternative Acquisition Agreement with respect to a Superior Proposal, but only if (x) Capella is permitted to terminate the merger agreement and accept such Superior Proposal, and (y) immediately prior to or substantially concurrently with such termination, Capella pays a termination fee to Strayer.

If the merger agreement is validly terminated, the merger agreement will become void and of no effect without liability of any party to any other party, except that certain designated provisions, including the provisions regarding termination fees, will survive termination.

$
703,895

$
670,375

$
—

$
(523
)

$
669,852

Total Operating Expenses

573,486

238

(184
)

573,540

563,361

648

(523
)

563,486

Operating Income (Loss)

130,593

(238
)

—

130,355

107,014

(648
)

—

106,366

Total Other Non-Operating Income (Expense)

(121,714
)

(82
)

266

(121,530
)

(1,487
)

2,289

(317
)

485

Income (Loss)Before Income Tax Provision (Benefit)

8,879

(320
)

266

8,825

105,527

1,641

(317
)

106,851

Income tax provision

3,804

—

—

3,804

19,153

—

—

19,153

Net Income (Loss)

5,075

(320
)

266

5,021

86,374

1,641

(317
)

87,698

Less: Net income (loss) attributable to noncontrolling interests

178

(392
)

338

124

86

—

1,324

1,410

Net Income Attributable to Legg Mason, Inc.

$
4,897

$
72

$
(72

)

$
4,897

$
86,288

$
1,641

$
(1,641
)

$
86,288

	Six Months Ended September 30, 2014 Balance Before Consolidation of CIVs	CIVs	Eliminations	As Reported	September 30, 2013 Balance Before Consolidation of CIVs	CIVs	Eliminations	As Reported
Total Operating Revenues	$1,398,143	$—	$(367)	$1,397,776	$1,341,407	$—	$(1,138)	$1,340,269
Total Operating Expenses	1,147,801	441	(367)	1,147,875	1,150,187	1,320	(1,138)	1,150,369
Operating Income (Loss)	250,342	(441)	—	249,901	191,220	(1,320)	—	189,900
Total Other Non-Operating Income (Expense)	(128,530)	2,925	(1,203)	(126,808)	(12,001)	4,984	(1,145)	(8,162)
Income Before Income Tax Provision (Benefit)	121,812	2,484	(1,203)	123,093	179,219	3,664	(1,145)	181,738
Income tax provision	44,460	—	—	44,460	44,945	—	—	44,945
Net Income	77,352	2,484	(1,203)	78,633	134,274	3,664	(1,145)	136,793
Less: Net income attributable to noncontrolling interests	267	676	605	1,548	171	—	2,519	2,690
Net Income Attributable to Legg Mason, Inc.	$77,085	$1,808	$(1,808)	$77,085	$134,103	$3,664	$(3,664)	$134,103

Other non-operating income (expense) includes interest income, interest expense and net gains (losses) on investments and long-term debt of CIVs determined on an accrual basis.

The consolidation of CIVs has no impact on Net Income Attributable to Legg Mason, Inc.

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

	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Value as of September 30, 2014
Assets:				
Trading investments:				
Hedge funds	$1,128	$4,303	$16,391	$21,822
Proprietary funds	28,109	—	—	$28,109
Total trading investments	29,237	4,303	16,391	49,931
Investments:				
Private equity funds	—	—	32,229	32,229
	$29,237	$4,303	$48,620	$82,160

	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Value as of March 31, 2014
Assets:				
Trading investments:				
Hedge funds	$1,110	$3,941	$17,888	$22,939
Proprietary funds	27,524	—	—	$27,524
Total trading investments	28,634	3,941	17,888	$50,463
Investments:				
Private equity funds	—	—	31,810	31,810
	$28,634	$3,941	$49,698	$82,273
Liabilities:				
CLO debt	$—	$—	$(79,179)	$(79,179)
Derivative liabilities	—	(1,888)	—	(1,888)
	$—	$(1,888)	$(79,179)	$(81,067)

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Except for the CLO debt, substantially all of the above financial instruments where valuation methods rely on other than observable market inputs as a significant input utilize the NAV practical expedient, such that measurement uncertainty has little relevance. During the three months ended June 30, 2014, the CLO substantially liquidated and was not consolidated as of September 30, 2014. As of March 31, 2014, the carrying value of the CLO debt approximated the amount to be paid to investors, and there was no appreciable measurement uncertainty.

The changes in assets and (liabilities) of CIVs measured at fair value using significant unobservable inputs (Level 3) for the three and six months ended September 30, 2014 and 2013, are presented in the tables below:

	Value as of June 30, 2014	Purchases	Sales	Settlements / Other	Transfers	Realized and unrealized gains/(losses), net	Value as of September 30, 2014
Assets:							
Hedge funds	$17,052	$292	$(1,501)	$—	$—	$ 548	$16,391
Private equity funds	35,117	—	(2,397)	—	—	(491)	32,229
	$52,169	$292	$(3,898)	$—	$—	$ 57	$48,620

	Value as of June 30, 2013	Purchases	Sales	Settlements / Other	Transfers	Realized and unrealized gains/(losses), net	Value as of September 30, 2013
Assets:							
Hedge funds	$20,189	$808	$(1,947)	$—	$—	$ 785	$19,835
Private equity funds	29,729	—	—	—	—	(1,809)	27,920
	$49,918	$808	$(1,947)	$—	$—	$ (1,024)	$47,755
Liabilities:							
CLO debt	$(153,676)	$—	$—	$49,040	$—	$ 2,863	$(101,773)
Total realized and unrealized gains (losses), net						$ 1,839	

	Value as of March 31, 2014	Purchases	Sales	Settlements / Other	Transfers	Realized and unrealized gains/(losses), net	Value as of September 30, 2014
Assets:							
Hedge funds	$17,888	$452	$(2,183)	$—	$—	$ 234	$16,391
Private equity funds	31,810	1,013	(2,397)	—	—	1,803	32,229
	$49,698	$1,465	$(4,580)	$—	$—	$ 2,037	$48,620
Liabilities:							
CLO debt	$(79,179)	$—	$—	$79,179	$—	$ —	$—
Total realized and unrealized gains (losses), net						$ 2,037	

	Value as of March 31, 2013	Purchases	Sales	Settlements / Other	Transfers	Realized and unrealized gains/(losses), net	Value as of September 30, 2013
Assets:							
Hedge funds	$19,448	$2,808	$(4,352)	$—	$—	$ 1,931	$19,835
Private equity funds	26,982	596	—	—	—	342	27,920
	$46,430	$3,404	$(4,352)	$—	$—	$ 2,273	$47,755
Liabilities:							
CLO debt	$(207,835)	$—	$—	$103,329	$—	$ 2,733	$(101,773)
Total realized and unrealized gains (losses), net						$ 5,006	

Realized and unrealized gains and losses recorded for Level 3 assets and liabilities of CIVs are included in Other non-operating income (expense) of CIVs in the Consolidated Statements of Income. Total unrealized gains (losses) for Level 3 investments and liabilities of CIVs relating only to those assets and liabilities still held at the reporting date were $(520) and $2,306 for the three months ended September 30, 2014 and 2013, respectively, and were $1,330 and $3,992 for the six months ended September 30, 2014 and 2013, respectively.

There were no transfers between Level 1 and Level 2 during either of the three and six months ended September 30, 2014 and 2013.

The NAVs used as a practical expedient by CIVs have been provided by the investees and have been derived from the fair values of the underlying investments as of the respective reporting dates. The following table summarizes, as of September 30, 2014 and March 31, 2014, the nature of these investments and any related liquidation restrictions or other factors, which may impact the ultimate value realized:

		Fair Value Determined Using NAV		As of September 30, 2014	
Category of Investment	Investment Strategy	September 30, 2014	March 31, 2014	Unfunded Commitments	Remaining Term
Hedge funds	Global macro, fixed income, long/short equity, systematic, emerging market, U.S. and European hedge	$21,822 (1)	$22,939 (2)	n/a	n/a
Private equity funds	Long/short equity	32,229 (3)	31,810 (3)	$2,707	3 years
Total		$54,051	$54,749	$2,707	

n/a – not applicable

(1) Redemption restrictions: 7% daily redemption; 6% monthly redemption; 3% quarterly redemption; and 84% are subject to three to five year lock-up or side pocket provisions.

(2) Redemption restrictions: 10% daily redemption; 6% monthly redemption; 2% quarterly redemption; and 82% are subject to three to five year lock-up or side pocket provisions.

(3) Liquidations are expected over the remaining term.

There are no current plans to sell any of these investments held as of September 30, 2014.

As of March 31, 2014, Legg Mason elected the fair value option for certain eligible assets and liabilities, including corporate loans and debt, of the consolidated CLO. Management believed that the use of the fair value option mitigated the impact of certain timing differences and better matched the changes in fair value of assets and liabilities related to the CLO. Legg Mason did not elect the fair value option for any assets or liabilities as of September 30, 2014, as the CLO was no longer consolidated.

The following table presents the fair value and unpaid principal balance of CLO debt carried at fair value under the fair value option as of March 31, 2014:

	March 31, 2014
Principal amounts outstanding	$92,114
Excess unpaid principal over fair value	(12,935)
Fair value	$79,179

During the three and six months ended September 30, 2013, total net gains of $1,480 and $1,314, respectively, were recognized in Other non-operating income of CIVs, net, in the Consolidated Statements of Income related to assets and liabilities for which the fair value option was elected. CLO loans and CLO debt measured at fair value have floating interest rates, therefore, substantially all of the estimated gains and losses included in earnings for the six months ended September 30, 2013, were attributable to instrument specific credit risk.

As of September 30, 2014, there were no derivative liabilities of CIVs. Total derivative liabilities of CIVs of $1,888 as of March 31, 2014, are recorded in Other liabilities of CIVs. Gains and (losses) of $308 and $(317), respectively, for the three months ended September 30, 2013 and gains and (losses) of $665 and $(632), respectively, for the six months ended September 30, 2013, related to derivative liabilities of CIVs are included in Other non-operating income (loss) of CIVs.

As of September 30, 2014 and March 31, 2014, for VIEs in which Legg Mason holds a 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 and maximum risk of loss were as follows:

	As of September 30, 2014		As of March 31, 2014	
	Equity Interests on the Consolidated Balance Sheet (1)	Maximum Risk of Loss (2)	Equity Interests on the Consolidated Balance Sheet (1)	Maximum Risk of Loss (2)
CLOs	$—	$911	$—	$911
Real Estate Investment Trust	648	14,336	1,442	3,715
Other sponsored investment funds	34,130	42,913	34,126	78,521
Total	$34,778	$58,160	$35,568	$83,147

(1) Includes $33,333 and $23,404 related to investments in proprietary funds products as of September 30, 2014 and March 31, 2014, respectively.

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

The Company's total AUM of unconsolidated VIEs was $16,714,792 and $16,032,764 as of September 30, 2014 and March 31, 2014, respectively.

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. These VIEs are not consolidated because either (1) Legg Mason does not have the power to direct significant economic activities of the entity and rights/obligations associated with benefits/losses that could be significant to the entity, or (2) Legg Mason does not absorb a majority of each VIE's expected losses or does not receive a majority of each VIE's expected residual gains.

13. Subsequent Event

On October 1, 2014, Legg Mason acquired all outstanding equity interests of Martin Currie, pursuant to a share purchase agreement dated July 24, 2014. See Note 9 for additional information.

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

Forward-looking Statements

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

Actual results may differ materially from those in forward-looking information as a result of various factors, some of which are beyond our control, including but not limited to those discussed under the heading "Risk Factors" and elsewhere herein, under the heading “Risk Factors” and elsewhere in our Annual Report on Form 10-K for the year ended March 31, 2014 and in our other public filings, press releases and statements by our management. Due to such risks, uncertainties and other factors, we caution each person receiving such forward-looking information not to place undue reliance on such statements. Further, such forward-looking statements speak only as of the date on which such statements are made, and we undertake no obligations to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events.

Executive Overview

Legg Mason, Inc., a holding company, with its subsidiaries (which collectively comprise "Legg Mason") is a global asset management firm. Acting through our subsidiaries, we provide investment management and related services to institutional and individual clients, company-sponsored mutual funds and other investment vehicles. We offer these products and services directly and through various financial intermediaries. We have operations principally in the United States of America and the United Kingdom and also have offices in Australia, Bahamas, Brazil, Canada, Chile, China, Dubai, France, Germany, Italy, Japan, Luxembourg, Poland, Singapore, Spain, Switzerland and Taiwan. Terms such as "we," "us," "our," and "Company" refer to Legg Mason.

The financial services business in which we are engaged is extremely competitive. Our competition includes numerous global, national, regional and local asset management firms, broker-dealers, commercial banks and other financial services companies. The industry has been impacted by continued economic uncertainty, the constant introduction of new products and services, and the consolidation of financial services firms through mergers and acquisitions. The industry in which we operate is also subject to extensive regulation under federal, state, and foreign laws. Like most firms, we have been and will continue to be impacted by regulatory and legislative changes. Responding to these changes and keeping abreast of regulatory developments, has required, and will continue to require, us to incur costs that continue to impact our profitability.

Our financial position and results of operations are materially affected by the overall trends and conditions of the financial markets, particularly in the United States, but increasingly in the other countries in which we operate. Results of any individual period should not be considered representative of future results. Our profitability is sensitive to a variety of factors, including the amount and composition of our AUM, and the volatility and general level of securities prices and interest rates, among other things. Sustained periods of unfavorable market conditions are likely to have an adverse effect on our profitability. 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. In the last few years, the industry has seen flows into products for which we do not currently garner significant market share. 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, 2014 and in Item 1A. herein.

Our strategic priorities are focused on four primary areas listed below. Management keeps these strategic priorities in mind when it evaluates our operating performance and financial condition. Consistent with this approach, we have also presented in the table below the most important initiatives on which management currently focuses in evaluating our performance and financial condition.

Strategic Priorities	Initiatives
Products	Create an innovative portfolio of investment products and promote revenue growth through new product development and leveraging the capabilities of our affiliates Identify and execute strategic acquisitions to increase product offerings and fill gaps in products and services
Performance	Deliver compelling and consistent performance against both relevant benchmarks and the products and services of our competitors
Distribution	Evaluate and reallocate resources within and to our distribution platform to continue to maintain and enhance our top tier distribution function with the capability to offer solutions to relevant investment challenges and grow market share worldwide
Productivity	Operate with a high level of effectiveness and improve ongoing efficiency Align affiliate economic relationships, including the implementation of management equity plan agreements

The strategic priorities discussed above are designed to drive improvements in our net flows, earnings, cash flows, AUM and other key metrics, including operating margin. Certain of these key metrics are discussed in our quarterly results discussion below. In connection with these strategic priorities, during the quarter ended June 30, 2014, we acquired QS Investors Holdings, LLC ("QS Investors"). During the quarters ended September 30, 2014 and June 30, 2014, we incurred approximately $8.7 million and $14.4 million, respectively, in expenses related to the integration over time of two of our existing affiliates, QS Batterymarch Financial Management, Inc. ("Batterymarch") and QS Legg Mason Global Asset Allocation, LLC ("LMGAA") into QS Investors, and various other corporate initiatives. In connection with the integration of Batterymarch and LMGAA into QS Investors, we expect to incur up to approximately $16 million in additional restructuring and transition costs, with up to approximately $13 million of the anticipated remaining costs expected to be incurred in the remainder of fiscal 2015.

Also in connection with these strategic priorities, on October 1, 2014, we acquired Martin Currie (Holdings) Limited ("Martin Currie"). Martin Currie is a leading global equities specialist based in the United Kingdom with $9.5 billion of AUM as of September 30, 2014. In addition, in June 2014, we announced an agreement to sell all of our equity interests in Legg Mason Investment Counsel & Trust Company N.A. (subsequently renamed 1919 Investment Counsel & Trust) ("LMIC"), to Stifel Financial Corporation's Global Wealth Management segment. The sale is expected to be completed in November 2014, and is not expected to have a material impact on our consolidated financial condition or results of operations. See Notes 3 and 9 of Notes to Consolidated Financial Statements for additional information.

Savings realized as a result of the various corporate initiatives implemented in the prior year, including closing down and reorganizing certain businesses, and ongoing efforts to increase efficiency and effectiveness, are being reinvested into our centralized global distribution business. As a result of reinvesting these savings, we expect to incur run rate expenses of approximately $5 million in the quarter ending December 31, 2014, increasing to $6 million to $7 million per quarter beginning in the quarter ending March 31, 2015.

Net Income Attributable to Legg Mason, Inc. for the three months ended September 30, 2014 was $4.9 million, or $0.04 per diluted share, as compared to $86.3 million, or $0.70 per diluted share for the three months ended September 30, 2013. The three months ended September 30, 2014, included a pre-tax, non-operating charge of $107.1 million, or $0.59 per diluted share, related to the refinancing of our 5.5% Senior Notes that was initiated in June 2014 and finalized in July 2014 (see Note 7 of Notes to Consolidated Financial Statements for additional information).

Average long-term AUM and total revenues increased during the three months ended September 30, 2014, as compared to the three months ended September 30, 2013. Strong overall investment performance and the improvement of our global distribution function contributed to modest long-term asset inflows in the 12-month period ended September 30, 2014. Over this period, increases in AUM due to market performance, an acquisition and net client inflows, offset the reclassification of certain client assets previously reported as AUM to AUA, as further discussed below.

The following discussion and analysis provides additional information regarding our financial condition and results of operations.

Business Environment
During the three months ended September 30, 2014, the economic environment was characterized by continued domestic growth and improved economic data, with markets becoming increasingly sensitive to economic news during the quarter.

All three major U.S. equity market indices increased during both the three and six months ended September 30, 2014 and 2013, while overall equity indices and bond indices were mixed.

	% Change for the three months ended September 30:		% Change for the six months ended September 30:	
Indices[1]	2014	2013	2014	2013
Dow Jones Industrial Average	1.2 %	1.5 %	3.6 %	3.8 %
S&P 500	0.6 %	4.7 %	5.3 %	7.2 %
NASDAQ Composite Index	1.9 %	10.8 %	7.1 %	15.4 %
Barclays Capital U.S. Aggregate Bond Index	0.2 %	0.6 %	2.2 %	(1.8)%
Barclays Capital Global Aggregate Bond Index	(3.1)%	2.8 %	(0.8)%	(0.1)%

(1) Indices are trademarks of Dow Jones & Company, McGraw-Hill Companies, Inc., NASDAQ Stock Market, Inc., and Barclays Capital, respectively, which are not affiliated with Legg Mason.

During the six months ended September 30, 2014, the Federal Reserve Board held the federal funds rate at 0.25%. While the economic outlook has remained more positive in recent years, the financial environment in which we operate continues to reflect a heightened level of sensitivity as we move through fiscal 2015.

Quarter Ended September 30, 2014, Compared to Quarter Ended September 30, 2013

Assets Under Management and Assets Under Advisement

Assets Under Management
Our AUM is primarily managed across the following asset classes:

Equity	Fixed Income	Liquidity
Large Cap Growth	U.S. Intermediate Investment Grade	U.S. Managed Cash
Small Cap Core	Global Government	U.S. Municipal Cash
Large Cap Value	U.S. Credit Aggregate	
Equity Income	Global Opportunistic Fixed Income	
Sector Equity	U.S. Municipal	
International Equity	Global Fixed Income	
Global Equity	U.S. Long Duration	
Mid Cap Core	U.S. High Yield	
Large Cap Core	U.S. Limited Duration	
	Emerging Markets	

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

	2014	2013
Beginning of period	$704.3	$644.5
Investment funds, excluding liquidity funds[1]		
Subscriptions	18.8	13.1
Redemptions	(16.3)	(15.1)
Separate account flows, net	(2.0)	(1.8)
Liquidity fund flows, net	12.9	2.4
Net client cash flows	13.4	(1.4)
Market performance and other[2]	(9.9)	14.2
Disposition	—	(1.3)
End of period	$707.8	$656.0

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

(2) Includes the impact of foreign exchange movements, primarily related to fixed income securities, of $(7.4) billion and $2.4 billion, for the three months ended September 30, 2014 and 2013, respectively.

AUM at September 30, 2014 was $707.8 billion, an increase of $3.5 billion, or 0.5%, from June 30, 2014. The increase in AUM was attributable to net client inflows of $13.4 billion, partially offset by the negative impact of market performance and other of $9.9 billion. Market performance and other includes $7.4 billion resulting from the negative impact of foreign currency exchange fluctuations. There were $12.7 billion of net client inflows into the liquidity asset class, primarily into low fee money market funds, and $0.7 billion of net client inflows into long-term asset classes, with equity net inflows of $1.6 billion partially offset by fixed income net outflows of $0.9 billion. Equity net inflows were primarily in products managed by ClearBridge Investments ("ClearBridge") and Brandywine Global Investment Management, LLC ("Brandywine"), partially offset by net outflows at Royce & Associates ("Royce"). We have experienced equity net inflows in two of the most recent three quarters, after experiencing equity net outflows, due in part to product investment performance, in all but one quarter since the fourth quarter of fiscal 2006. We generally earn higher fees and profits on equity AUM where net flows will more heavily impact our revenues and Net Income Attributable to Legg Mason, Inc. than would outflows in the fixed income and liquidity asset classes. Fixed income net outflows were primarily in products managed by Western Asset Management ("Western Asset"), partially offset by net inflows at Brandywine. We have experienced fixed income net inflows in four of the most recent six quarters after experiencing fixed income net outflows in all but two quarters of the preceding five fiscal years.

AUM by Asset Class

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

	2014	% of Total	2013	% of Total	% Change
Equity	$193.6	27 %	$169.5	26 %	14 %
Fixed Income	360.4	51	355.0	54	2
Liquidity	153.8	22	131.5	20	17
Total	$707.8	100 %	$656.0	100 %	8 %

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

	2014	% of Total	2013	% of Total	% Change
Equity	$194.6	27 %	$166.8	26 %	17 %
Fixed Income	364.1	52	351.5	54	4
Liquidity	145.4	21	132.1	20	10
Total	$704.1	100 %	$650.4	100 %	8 %

The component changes in our AUM by asset class (in billions) for the three months ended September 30, 2014 and 2013, were as follows:

	Equity	Fixed Income	Liquidity	Total
June 30, 2014	$196.0	$366.7	$141.6	$704.3
Investment funds, excluding liquidity funds				
Subscriptions	7.1	11.7	—	18.8
Redemptions	(8.0)	(8.3)	—	(16.3)
Separate account flows, net	2.5	(4.3)	(0.2)	(2.0)
Liquidity fund flows, net	—	—	12.9	12.9
Net client cash flows	1.6	(0.9)	12.7	13.4
Market performance and other	(4.0)	(5.4)	(0.5)	(9.9)
September 30, 2014	$193.6	$360.4	$153.8	$707.8

	Equity	Fixed Income	Liquidity	Total
June 30, 2013	$164.4	$351.0	$129.1	$644.5
Investment funds, excluding liquidity funds				
Subscriptions	6.4	6.7	—	13.1
Redemptions	(7.2)	(7.9)	—	(15.1)
Separate account flows, net	(3.2)	1.5	(0.1)	(1.8)
Liquidity fund flows, net	—	—	2.4	2.4
Net client cash flows	(4.0)	0.3	2.3	(1.4)
Market performance and other	10.4	3.7	0.1	14.2
Disposition	(1.3)	—	—	(1.3)
September 30, 2013	$169.5	$355.0	$131.5	$656.0

The component changes in our AUM by asset class (in billions) for the trailing 12 months ended September 30, 2014 and 2013, were as follows:

	Equity	Fixed Income	Liquidity	Total
September 30, 2013	$169.5	$355.0	$131.5	$656.0
Investment funds, excluding liquidity funds				
Subscriptions	27.4	30.4	—	57.8
Redemptions(1)	(31.0)	(25.5)	—	(56.5)
Separate account flows, net	3.1	(3.3)	0.9	0.7
Liquidity fund flows, net	—	—	21.4	21.4
Net client cash flows	(0.5)	1.6	22.3	23.4
Market performance and other(2)	20.3	3.1	—	23.4
Acquisition	4.3	0.7	—	5.0
September 30, 2014	$193.6	$360.4	$153.8	$707.8

(1) Fixed income redemptions include $2.6 billion related to a single, low-fee global sovereign mandate client. Assets related to this client were reclassified from AUM to AUA in the three months ended June 30, 2014, as further discussed below.

(2) Total market performance and other includes the impact of foreign exchange movements of $(7.3) billion, primarily related to fixed income securities. Also includes the reclassification of $12.8 billion of client assets from AUM to AUA.

	Equity	Fixed Income	Liquidity	Total
September 30, 2012	$153.4	$369.4	$127.9	$650.7
Investment funds, excluding liquidity funds				
Subscriptions	23.1	26.9	—	50.0
Redemptions(1)	(29.3)	(29.0)	—	(58.3)
Separate account flows, net	(9.4)	(3.9)	(1.8)	(15.1)
Liquidity fund flows, net	—	—	4.2	4.2
Net client cash flows	(15.6)	(6.0)	2.4	(19.2)
Market performance and other(2)	27.6	(8.4)	1.2	20.4
Acquisition (dispositions), net	4.1	—	—	4.1
September 30, 2013	$169.5	$355.0	$131.5	$656.0

(1) Fixed income redemptions include $5.2 billion related to a single, low-fee global sovereign mandate client. Assets related to this client were reclassified from AUM to AUA in the three months ended June 30, 2014, as further discussed below.

(2) Total market performance and other includes the impact of foreign exchange movements of $(13.0) billion, primarily related to fixed income securities.

AUM at September 30, 2014 increased by $51.8 billion, or 7.9%, from September 30, 2013. The AUM increase was attributable to the positive impact of $36.2 billion in market performance and other, net client inflows of $23.4 billion, and $5.0 billion related to the acquisition of QS Investors, offset in part by the reclassification of $12.8 billion of client assets from AUM to AUA, which is reflected in market performance and other, as further discussed below. There were $22.3 billion of net client inflows into the liquidity asset class, primarily into low fee money market funds, and $1.1 billion of net client inflows into long-term asset classes, with fixed income net inflows of $1.6 billion partially offset by equity net outflows of $0.5 billion. Fixed income net inflows were primarily in products managed by Brandywine, and were offset in part by net outflows in products managed by Western Asset. Equity net outflows were primarily in products managed by Royce and QS Investors, including legacy Batterymarch, and were offset in part by equity net inflows in products managed by ClearBridge and Brandywine.

AUM by Distribution Channel

Broadly, we have two principal distribution channels, Global Distribution and Affiliate/Other, through which we sell a variety of investment products and services. Global Distribution, which consists of our centralized global distribution operations, principally sells U.S. and international mutual funds and other commingled vehicles, retail separately managed account programs, and sub-advisory accounts for insurance companies and similar clients. Affiliate/Other consists of the distribution operations within our asset managers, which principally sell institutional separate accounts and liquidity (money market) funds.

The component changes in our AUM by distribution channel (in billions) for the three months ended September 30, 2014 and 2013, were as follows:

	Global Distribution	Affiliate/Other	Total
June 30, 2014	$257.7	$446.6	$704.3
Net client cash flows, excluding liquidity funds	4.4	(3.9)	0.5
Liquidity fund flows, net	—	12.9	12.9
Net client cash flows	4.4	9.0	13.4
Market performance and other	(5.6)	(4.3)	(9.9)
September 30, 2014	$256.5	$451.3	$707.8

	Global Distribution	Affiliate/Other	Total
June 30, 2013	$231.7	$412.8	$644.5
Net client cash flows, excluding liquidity funds	(2.4)	(1.4)	(3.8)
Liquidity fund flows, net	—	2.4	2.4
Net client cash flows	(2.4)	1.0	(1.4)
Market performance and other	5.7	8.5	14.2
Disposition	—	(1.3)	(1.3)
September 30, 2013	$235.0	$421.0	$656.0

Effective Fee Rates

For three months ended September 30, 2014 and 2013, our overall effective fee rate across all asset classes and distribution channels was 33 and 34 basis points, respectively. Fees for managing equity assets are generally higher, averaging approximately 65 basis points and 70 basis points for the three months ended September 30, 2014 and 2013, respectively. This compares to fees for managing fixed income assets, which averaged approximately 25 basis points for each of the quarters ended September 30, 2014 and 2013, and liquidity assets, which averaged under 10 basis points (reflecting the impact of current advisory fee waivers due to the low interest rate environment) for each of the quarters ended September 30, 2014 and 2013. Equity assets are primarily managed by ClearBridge, Royce, QS Investors (including legacy Batterymarch assets), Brandywine, and The Permal Group, Ltd. ("Permal"); fixed income assets are primarily managed by Western Asset, Brandywine, and Permal; and liquidity assets are managed by Western Asset. Fee rates for assets distributed through Legg Mason Global Distribution, which are predominately retail in nature, averaged approximately 50 basis points for each of the quarters ended September 30, 2014 and 2013, while fee rates for assets distributed through the Affiliate/Other channel averaged approximately 30 basis points for each of the quarters ended September 30, 2014 and 2013.

Investment Performance

Overall investment performance of our AUM for the three months ended September 30, 2014 and 2013, was generally favorable compared to relevant benchmarks.

For the three months ended September 30, 2014, most U.S. equity indices produced mixed returns. The best performing was the NASDAQ Composite, returning 1.9% for the three months ended September 30, 2014. These returns were achieved in an economic environment characterized by continued domestic growth and improved economic data, mixed with heightened sensitivity to economic news.

In the fixed income markets, while the Federal Reserve continued to taper its bond-buying program, as expected, short and intermediate rates ended the quarter generally higher and longer-dated rates ended the quarter generally lower than the prior quarter. Investors’ demand for risk was generally mixed over the quarter with most fixed income asset classes underperforming U.S. Treasuries as geopolitical tensions flared and prospects for global growth weakened. The lowest yielding fixed income sector for the quarter was U.S. Treasury Inflation-Protected Securities ("TIPS"), as measured by the Barclays U.S. TIPS Index returning (2.0)%. The best performing fixed income sector for the quarter was U.S. Government as measured by the Barclays U.S. Government Index returning 0.3% as of September 30, 2014.

The following table presents a summary of the percentages of our AUM by strategy(1) that outpaced their respective benchmarks as of September 30, 2014 and 2013, for the trailing 1-year, 3-year, 5-year, and 10-year periods:

	As of September 30, 2014				As of September 30, 2013			
	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year
Total (includes liquidity)	83 %	85 %	88 %	92 %	80 %	82 %	89 %	91 %
Equity:								
Large cap	62 %	65 %	77 %	87 %	62 %	67 %	91 %	74 %
Small cap	49 %	30 %	28 %	63 %	27 %	16 %	51 %	69 %
Total equity (includes other equity)	57 %	58 %	63 %	81 %	53 %	49 %	73 %	72 %
Fixed income:								
U.S. taxable	90 %	93 %	94 %	93 %	95 %	93 %	89 %	97 %
U.S. tax-exempt	97 %	100 %	100 %	100 %	3 %	100 %	100 %	100 %
Global taxable	89 %	88 %	97 %	93 %	86 %	84 %	96 %	93 %
Total fixed income	90 %	92 %	95 %	94 %	85 %	90 %	93 %	96 %

The following table presents a summary of the percentages of our U.S. mutual fund assets(2) that outpaced their Lipper category averages as of September 30, 2014 and 2013, for the trailing 1-year, 3-year, 5-year, and 10-year periods:

	As of September 30, 2014				As of September 30, 2013			
	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year
Total (excludes liquidity)	60 %	58 %	57 %	68 %	48 %	62 %	69 %	68 %
Equity:								
Large cap	75 %	74 %	66 %	60 %	48 %	79 %	76 %	53 %
Small cap	32 %	20 %	20 %	70 %	36 %	22 %	50 %	73 %
Total equity (includes other equity)	51 %	51 %	47 %	62 %	48 %	49 %	61 %	60 %
Fixed income:								
U.S. taxable	80 %	87 %	91 %	82 %	61 %	91 %	91 %	90 %
U.S. tax-exempt	68 %	54 %	58 %	86 %	24 %	86 %	77 %	83 %
Global taxable	83 %	69 %	84 %	71 %	65 %	67 %	83 %	60 %
Total fixed income	77 %	72 %	78 %	83 %	49 %	86 %	85 %	85 %

(1) 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.

As of September 30, 2014 and 2013, 90% and 91% of total AUM is included in strategy AUM, respectively, 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 included 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.

(2) Source: Lipper Inc. includes open-end, closed-end, and variable annuity funds. As of September 30, 2014 and 2013, the U.S. long-term mutual fund assets represented in the data accounted for 19% and 20%, respectively, of our total AUM. The performance of our U.S. long-term mutual fund assets is included in the strategies.

The following table presents a summary of the absolute and relative performance compared to the applicable benchmark for a representative sample of funds within our AUM, net of management and other fees as of the end of the period presented, for the 1-year, 3-year, 5-year, and 10-year periods, and from each fund's inception. The table below includes a representative sample of funds from each significant subclass of our investment strategies (i.e., large cap equity, small cap equity, etc.). The funds within this group are representative of the performance of significant investment strategies we offer, that as of September 30, 2014, constituted an aggregate of approximately $443 billion, or approximately 63% of our total AUM. The only meaningful exclusion of funds are our fund-of-hedge funds strategies, which involve privately placed hedge funds, and represent only 3% of our total assets under management as of September 30, 2014, for which investment performance is not made publicly available. Providing investment returns of funds provides a relevant representation of our performance while avoiding the many complexities relating to factors such as multiple fee structures, bundled pricing, and asset level break points, that would arise in reporting performance for strategies or other product aggregations.

			Annualized Absolute/Relative Total Return (%) vs. Benchmark				
Fund Name/Index[1]	Inception Date	Performance Type[2]	1-year	3-year	5-year	10-year	Inception
Equity							
Large Cap							
ClearBridge Aggressive Growth Fund	10/24/1983	Absolute	22.70%	29.65%	20.39%	9.49%	12.67%
Russell 3000 Growth		Relative	4.83%	7.24%	3.96%	0.53%	2.66%
ClearBridge Equity Income	11/6/1992	Absolute	15.46%	19.48%	14.34%	7.31%	8.70%
Russell 3000 Value		Relative	(2.20)%	(4.19)%	(0.75)%	(0.48)%	(1.51)%
ClearBridge Appreciation Fund	3/10/1970	Absolute	16.07%	20.79%	13.79%	8.05%	10.44%
S&P 500		Relative	(3.67)%	(2.21)%	(1.91)%	(0.05)%	(0.09)%
ClearBridge Value Trust	4/16/1982	Absolute	19.40%	23.90%	12.65%	2.90%	12.12%
S&P 500		Relative	(0.33)%	0.90%	(3.05)%	(5.21)%	0.15%
ClearBridge All Cap Value	11/12/1981	Absolute	14.35%	21.17%	11.85%	6.12%	10.39%
Russell 3000 Value		Relative	(3.31)%	(2.50)%	(3.23)%	(1.67)%	(1.71)%
ClearBridge Large Cap Value Fund	12/31/1988	Absolute	17.98%	23.23%	14.79%	8.00%	9.70%
Russell 1000 Value		Relative	(0.91)%	(0.70)%	(0.46)%	0.16%	(0.86)%
ClearBridge Large Cap Growth Fund	8/29/1997	Absolute	19.73%	24.90%	15.58%	7.98%	7.86%
Russell 1000 Growth		Relative	0.58%	2.45%	(0.92)%	(0.96)%	2.10%
Legg Mason Brandywine Diversified Large Cap Value Fund	9/7/2010	Absolute	18.70%	22.33%	n/a	n/a	17.65%
Russell 1000 Value		Relative	(0.19)%	(1.60)%	n/a	n/a	0.75%
Small Cap							
Royce Pennsylvania Mutual	6/30/1967	Absolute	3.29%	18.32%	12.56%	8.45%	11.91%
Russell 2000		Relative	(0.64)%	(2.94)%	(1.73)%	0.27%	n/a
Royce Premier Fund	12/31/1991	Absolute	5.86%	16.13%	12.55%	10.05%	12.13%
Russell 2000		Relative	1.93%	(5.13)%	(1.74)%	1.86%	2.61%
Royce Total Return Fund	12/15/1993	Absolute	4.44%	17.93%	13.08%	7.99%	11.06%
Russell 2000		Relative	0.51%	(3.33)%	(1.20)%	(0.20)%	2.38%
ClearBridge Small Cap Growth	7/1/1998	Absolute	2.35%	23.90%	16.89%	10.04%	10.51%
Russell 2000 Growth		Relative	(1.44)%	2.00%	1.38%	1.01%	4.48%
Royce Special Equity	5/1/1998	Absolute	(1.04)%	16.50%	11.60%	8.15%	9.37%
Russell 2000		Relative	(4.97)%	(4.76)%	(2.68)%	(0.04)%	2.43%

Fund Name/Index	Inception Date	Performance Type(1)	Annualized Absolute/Relative Total Return (%) vs. Benchmark				
			1-year	3-year	5-year	10-year	Inception
Fixed Income							
U.S. Taxable							
Western Asset Core Plus Fund	7/8/1998	Absolute	6.52%	4.95%	7.10%	5.91%	6.55%
Barclays US Aggregate		Relative	2.57%	2.52%	2.98%	1.29%	1.16%
Western Asset Core Bond Fund	9/4/1990	Absolute	5.93%	3.91%	6.66%	5.12%	7.23%
Barclays US Aggregate		Relative	1.97%	1.48%	2.54%	0.50%	0.70%
Western Asset Total Return Unconstrained	7/6/2006	Absolute	4.34%	4.46%	5.27%	n/a	5.31%
Barclays US Aggregate		Relative	0.38%	2.02%	1.15%	n/a	0.13%
Western Asset Short Term Bond Fund	11/11/1991	Absolute	1.45%	1.74%	3.17%	2.01%	3.81%
Citi Treasury Gov't/Credit 1-3 YR		Relative	0.71%	0.82%	1.74%	(0.85)%	(0.68)%
Western Asset Inflation Index Plus Bond	3/1/2001	Absolute	1.08%	1.10%	4.27%	4.47%	5.70%
Barclays US TIPS		Relative	(0.51)%	(0.24)%	0.21%	(0.16)%	(0.19)%
Western Asset Intermediate Bond Fund	7/1/1994	Absolute	3.28%	3.38%	4.95%	4.85%	6.10%
Barclays Intermediate Gov't/Credit		Relative	1.09%	1.37%	1.53%	0.80%	0.62%
Western Asset High Yield Fund	9/28/2001	Absolute	6.90%	10.87%	10.63%	7.51%	8.14%
Barclays US Corp High Yield		Relative	(0.30)%	(0.23)%	0.06%	0.82%	(1.17)%
Western Asset Mortgage Defined Opportunity Fund Inc.	2/24/2010	Absolute	19.86%	21.69%	n/a	n/a	18.55%
BOFAML Floating Rate Home Loan Index		Relative	15.78%	13.02%	n/a	n/a	11.71%
Western Asset Corporate Bond Fund	11/6/1992	Absolute	9.21%	7.92%	8.22%	4.81%	6.76%
Barclays US Credit		Relative	2.57%	3.10%	2.12%	(0.60)%	0.06%
Western Asset Adjustable Rate Income	6/22/1992	Absolute	1.37%	2.45%	3.44%	1.81%	2.92%
Citi T-Bill 6-Month		Relative	1.30%	2.35%	3.31%	0.15%	(0.09)%
U.S. Tax-Exempt							
Western Asset Managed Municipals Fund	3/4/1981	Absolute	10.04%	5.65%	5.12%	5.40%	8.02%
Barclays Municipal Bond		Relative	2.11%	1.09%	0.44%	0.68%	0.52%
Global Taxable							
Legg Mason Brandywine Global Opportunities Bond	11/1/2006	Absolute	5.89%	5.26%	7.17%	n/a	7.03%
Citi World Gov't Bond		Relative	5.96%	5.77%	5.59%	n/a	2.97%
Legg Mason Western Asset Global Multi Strategy Fund	8/31/2002	Absolute	4.54%	4.42%	4.38%	5.28%	7.07%
50% Bar. Global Agg./ 25% Bar. HY 2%/25% JPM EMBI +		Relative	0.20%	(0.62)%	(1.48)%	(1.18)%	(0.83)%
Legg Mason Brandywine Global Fixed Income	10/31/2003	Absolute	3.02%	2.40%	4.82%	4.86%	5.28%
Citi World Gov't Bond		Relative	3.09%	2.91%	3.24%	0.78%	0.85%
Western Asset Global High Yield Bond Fund	2/22/1995	Absolute	5.11%	10.55%	9.42%	6.71%	7.72%
Barclays Global High Yield		Relative	(1.40)%	(1.02)%	(0.97)%	(2.17)%	(1.92)%
Western Asset Emerging Markets Debt	10/17/1996	Absolute	5.86%	5.96%	6.61%	8.19%	10.31%

JPM EMBI Global		Relative	(2.41)%	(1.73)%	(1.34)%	(0.19)%	0.77%
Legg Mason Western Asset Australian Bond Trust	6/30/1983	Absolute	6.67%	7.11%	8.07%	6.80%	6.49%
UBS Australian Composite Bond Index		Relative	0.65%	1.35%	1.35%	0.62%	0.63%
Legg Mason Western Asset Global Core Plus Bond	12/31/2010	Absolute	8.23%	6.75%	n/a	n/a	5.40%
Barclays Global Aggregate Index		Relative	2.73%	2.86%	n/a	n/a	1.09%
Liquidity							
Western Asset Institutional Liquid Reserves Ltd.	12/31/1989	Absolute	0.07%	0.13%	0.16%	1.83%	3.49%
Citi 3-Month T-Bill		Relative	0.03%	0.07%	0.08%	0.32%	0.30%

(1) In order of size based on AUM of fund within each subcategory.

(2) Absolute performance is the actual performance (i.e., rate of return) of the fund. Relative performance is the difference (or variance) between the performance of the fund and its stated benchmark.

Assets Under Advisement
As of September 30, 2014, AUA was $117.3 billion. As of September 30, 2014, AUA was primarily comprised of $99.6 billion related to QS Investors, $11.3 billion related to Western Asset and $5.6 billion related to ClearBridge. AUA fee rates vary with the level of non-discretionary service provided, and, as of September 30, 2014 our average annualized fee rate related to AUA was in the low single digit basis points. Fees for AUA are considered servicing fees and are therefore recorded in Distribution and service fees in the Consolidated Statement of Income for the three and six months ended September 30, 2014.

Results of Operations
In accordance with financial accounting standards on consolidation, we consolidate and separately identify certain sponsored investment vehicles. The consolidation of these investment vehicles has no impact on Net Income Attributable to Legg Mason, Inc. and does not have a material impact on our consolidated operating results. We also hold investments in other consolidated sponsored investment funds and the change in the value of these investments, which is recorded in Other non-operating income (expense), is reflected in our Net Income, net of amounts allocated to noncontrolling interests, if any. See Notes 2, 4, and 12 of Notes to Consolidated Financial Statements for additional information regarding the consolidation of investment vehicles.

Operating Revenues
The components of Total Operating Revenues (in millions), and the dollar and percentage changes between periods were as follows:

	Three Months Ended September 30,			
	2014	2013	$ Change	% Change
Investment advisory fees:				
Separate accounts	$204.8	$191.6	$13.2	7 %
Funds	389.2	372.7	16.5	4
Performance fees	14.0	17.4	(3.4)	(20)
Distribution and service fees	94.5	86.2	8.3	10
Other	1.4	2.0	(0.6)	(30)
Total Operating Revenues	$703.9	$669.9	$34.0	5 %

Total operating revenues for the three months ended September 30, 2014, were $703.9 million, an increase of 5% from $669.9 million for the three months ended September 30, 2013. This increase was primarily due to the impact of an 8% increase in average long-term AUM, offset in part by a decrease in performance fees. Average AUM advisory revenue yields were 33 basis points in the three months ended September 30, 2014, as compared to 34 basis points in the three months ended September 30, 2013. The decrease in average AUM advisory revenue yields was the result of a less favorable product mix, with lower yielding products comprising a higher percentage of our total average AUM for the three months ended September 30, 2014, as compared to the three months ended September 30, 2013.

Investment advisory fees from separate accounts increased $13.2 million, or 7%, to $204.8 million, as compared to $191.6 million for the three months ended September 30, 2013. Of this increase, $7.7 million was due to higher average fixed income assets managed by Western Asset and Brandywine, and $7.0 million was the result of higher average equity assets managed by ClearBridge. These increases were offset in part by a decrease of $2.0 million due to lower average equity assets managed by QS Investors, including those previously managed by legacy Batterymarch, which is being integrated over time into QS Investors.

Investment advisory fees from funds increased $16.5 million, or 4%, to $389.2 million, as compared to $372.7 million for the three months ended September 30, 2013. Of this increase, $23.5 million was due to higher average equity assets managed by ClearBridge and $4.7 million was due to higher average fixed income assets managed by Western Asset. These increases were offset in part by a decrease of $6.9 million due to lower average assets managed by

Permal and $5.7 million due to lower average equity assets managed by Royce.

Of our total AUM as of September 30, 2014 and 2013, approximately 6% was in accounts that were eligible to earn performance fees. Performance fees decreased $3.4 million, or 20%, to $14.0 million, as compared to $17.4 million for the three months ended September 30, 2013, primarily due to lower fees earned on assets managed by Permal, offset in part by higher fees earned on assets managed by Brandywine.

Distribution and service fees increased $8.3 million, or 10%, to $94.5 million, as compared to $86.2 million for the three months ended September 30, 2013. In connection with the acquisition of QS Investors and its related AUA, as well as the reclassification of certain existing client assets from AUM to AUA during the three months ended June 30, 2014, as previously discussed, approximately $9.7 million of revenues related to these client assets are now included in Distribution and service fees for fiscal 2015.

Operating Expenses

The components of Total Operating Expenses (in millions), and the dollar and percentage changes between periods were as follows:

	Three Months Ended September 30,			
	2014	2013	$ Change	% Change
Compensation and benefits	$303.9	$294.3	$9.6	3 %
Distribution and servicing	155.1	155.1	—	—
Communications and technology	44.6	40.0	4.6	12
Occupancy	22.7	24.9	(2.2)	(9)
Amortization of intangible assets	0.5	3.6	(3.1)	(86)
Other	46.7	45.6	1.1	2
Total Operating Expenses	$573.5	$563.5	$10.0	2 %

Operating expenses for the three months ended September 30, 2014 and 2013, incurred at the investment management affiliate level comprised approximately 70% of total operating expenses in each year. The remaining operating expenses are comprised of corporate and distribution costs.

The components of Compensation and benefits (in millions) for the three months ended September 30 were as follows:

	Three Months Ended September 30,			
	2014	2013	$ Change	% Change
Salaries and incentives	$249.0	$230.3	$18.7	8 %
Benefits and payroll taxes (including deferred compensation)	47.7	50.7	(3.0)	(6)
Transition costs and severance	7.6	9.1	(1.5)	(16)
Gains (losses) on deferred compensation and seed capital investments	(0.4)	4.2	(4.6)	n/m
Compensation and benefits	$303.9	$294.3	$9.6	3 %

n/m - not meaningful

Compensation and benefits increased 3% to $303.9 million for the three months ended September 30, 2014, as compared to $294.3 million for the three months ended September 30, 2013, as a result of the following:

- Salaries and incentives increased $18.7 million, to $249.0 million, as compared to $230.3 million for the three months ended September 30, 2013, principally due to an increase of $8.5 million in net compensation at investment affiliates, primarily due to the impact of increased revenues at certain revenue share-based affiliates, an increase of $5.0 million in sales-based incentive compensation for distribution personnel and a $1.9 million increase in incentive compensation for corporate personnel.

- Benefits and payroll taxes decreased $3.0 million, to $47.7 million, as compared to $50.7 million for the three months ended September 30, 2013, primarily as a result of a decrease in costs associated with certain employee benefit plans.

- Transition costs and severance decreased $1.5 million, to $7.6 million, as compared to $9.1 million for the three months ended September 30, 2013, primarily due to lower compensation costs associated with the previously discussed integration of Batterymarch and LMGAA over time into QS Investors, as compared to compensation costs associated with various corporate initiatives recognized in the prior year period.

- Gains (losses) on deferred compensation and seed capital investments for the three months ended September 30, 2014, were losses of $0.4 million, as compared to gains of $4.2 million for the three months ended September 30, 2013. The decrease was primarily due to net market losses on assets invested for deferred compensation plans and seed capital investments.

Compensation as a percentage of operating revenues decreased to 43.2% from 43.9%, due to the impact of compensation decreases related to net market losses on assets invested for deferred compensation plans and seed capital investments.

Distribution and servicing expenses remained flat at $155.1 million, as $4.4 million of structuring fees related to a closed-end fund launch during the three months ended September 30, 2014, were offset by the impact of adjustments related to distribution partner compensation and structuring fees related to a closed-end fund launch in the three months ended September 30, 2013.

Communications and technology expense increased 12% to $44.6 million, as compared to $40.0 million for the three months ended September 30, 2013, primarily as a result of an increase in technology consulting, depreciation and data management expenses.

Occupancy expense decreased 9% to $22.7 million, as compared to $24.9 million for the three months ended September 30, 2013, primarily due to reductions in lease reserves of $4.5 million recorded in the current year period, as compared to $3.1 million of similar adjustments recorded in the prior year period.

Amortization of intangible assets decreased 86% to $0.5 million, as compared to $3.6 million for the three months ended September 30, 2013, primarily due to certain management contracts becoming fully amortized in December 2013 and the reclassification of certain asset management contracts to assets held for sale in connection with the sale of LMIC.

Other expenses increased $1.1 million, or 2%, to $46.7 million, as compared to $45.6 million for the three months ended September 30, 2013, primarily due to a $1.9 million increase in travel and entertainment expenses and a $1.6 million increase in professional fees. These increases were offset in part by a $1.8 million decrease in expense reimbursements paid to certain mutual funds and a $0.8 million decrease in director fees.

Non-Operating Income (Expense)

The components of Total Other Non-Operating Income (Expense) (in millions), and the dollar and percentage changes between periods were as follows:

	Three Months Ended September 30,			
	2014	2013	$ Change	% Change
Interest income	$1.7	$1.4	$0.3	21 %
Interest expense	(15.0)	(12.9)	(2.1)	16 %
Other income (expense), net, including $107.1 million debt extinguishment loss in July 2014	(108.2)	9.7	(117.9)	n/m
Other non-operating income of consolidated investment vehicles, net	—	2.3	(2.3)	n/m
Total Other Non-Operating Income (Expense)	$(121.5)	$0.5	$(122.0)	n/m

n/m - not meaningful

Interest income increased 21% to $1.7 million, as compared to $1.4 million for the three months ended September 30, 2013, primarily due to higher yields earned on investment balances.

Interest expense increased 16% to $15.0 million, as compared to $12.9 million for the three months ended September 30, 2013, primarily due to the impact of refinancing the five-year term loan in January 2014 and the 5.5% Senior Notes, which closed in July 2014.

Other income (expense), net, decreased $117.9 million, to expense of $108.2 million, as compared to income of $9.7 million for the three months ended September 30, 2013. This decrease was primarily due to a $98.6 million make-whole provision charge and a write-down of $8.5 million, which together resulted in a $107.1 million charge related to the refinancing of the 5.5% Senior Notes, which was initiated in the three months ended June 30, 2014 and finalized in July 2014. Net market losses of $6.0 million on corporate investments, which are not offset in compensation, and net market losses of $4.6 million on seed capital investments and assets invested for deferred compensation plans, which are offset by corresponding decreases in compensation mentioned above, also contributed to the decrease.

Other non-operating income of consolidated investment vehicles ("CIVs"), net, decreased $2.3 million, primarily due to the deconsolidation of a collateralized loan obligation in the quarter ended June 30, 2014.

Income Tax Provision

The provision for income taxes was $3.8 million for the three months ended September 30, 2014, as compared to $19.2 million in the three months ended September 30, 2013. The effective tax rate was 43.1% for the three months ended September 30, 2014, as compared to 17.9% for the three months ended September 30, 2013. In July 2013, the Finance Bill 2013 was enacted, which reduced the main U.K. corporate tax rate from 23% to 21% effective April 1, 2014 and to 20% effective April 1, 2015. The impact of the tax rate changes on certain existing deferred tax assets and liabilities resulted in tax benefits of $19.2 million, and impacted the effective tax rate by 17.9 percentage points, in the three months ended September 30, 2013. The increase in the effective tax rate for the three months ended September 30, 2014, was primarily related to the impact of the U.K. tax rate changes in the prior year period, and the impact of the effective tax rate relative to the lower level of pre-tax income in the current year period. The impact of CIVs increased the effective tax rate by 0.3 percentage points in the September 2014 quarter and reduced the effective tax rate by 0.2 percentage points in the September 2013 quarter.

Net Income Attributable to Legg Mason, Inc. and Operating Margin

Net Income Attributable to Legg Mason, Inc. for the three months ended September 30, 2014, totaled $4.9 million, or $0.04 per diluted share, as compared to $86.3 million, or $0.70 per diluted share, in the three months ended September 30, 2013. The decrease was primarily attributable to the pre-tax, non-operating charge of $107.1 million ($68.5 million, net of income tax benefits, or $0.59 per diluted share) related to the refinancing of the 5.5% Senior Notes, which was finalized in July 2014. Operating margin was 18.5% for the three months ended September 30, 2014, as compared to 15.9% for the three months ended September 30, 2013.

Supplemental Non-GAAP Financial Information

Adjusted Income (see Supplemental Non-GAAP Financial Information below) decreased to $40.6 million, or $0.35 per diluted share, for the three months ended September 30, 2014, from $104.5 million, or $0.85 per diluted share, for the three months ended September 30, 2013, primarily due to the pre-tax, non-operating charge of $107.1 million ($68.5 million, net of income tax benefits, or $0.59 per diluted share) related to the refinancing of the 5.5% Senior Notes. Operating Margin, as Adjusted (see Supplemental Non-GAAP Financial Information below), for the three months ended September 30, 2014 and 2013, was 23.8% and 22.3%, respectively. Operating Margin, as Adjusted, for the three months ended September 30, 2014, was reduced by 1.6 percentage points due to costs associated with the integration of Batterymarch and LMGAA over time into QS Investors and various other corporate initiatives and by 0.8 percentage points due to structuring fees related to a closed-end fund launch during the period.

Six Months Ended September 30, 2014, Compared to Six Months Ended September 30, 2013

Assets Under Management and Assets Under Advisement

Assets Under Management

The components of the changes in our AUM (in billions) for the six months ended September 30, were as follows:

	2014	2013
Beginning of period	$701.8	$664.6
Investment funds, excluding liquidity funds(1)		
Subscriptions	32.3	26.6
Redemptions	(29.1)	(30.8)
Separate account flows, net	(2.0)	(0.1)
Liquidity fund flows, net	3.9	(5.6)
Net client cash flows	5.1	(9.9)
Market performance and other (2)	(4.1)	2.6
Acquisition (disposition)	5.0	(1.3)
End of period	$707.8	$656.0

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

(2) Includes the impact of foreign exchange movements, primarily related fixed income securities, of $(5.8) billion and $(3.4) billion, for the six months ended September 30, 2014 and 2013, respectively. Also includes the reclassification of $12.8 billion of client assets from AUM to AUA for the six months ended September 30, 2014, the reinvestment of dividends and other.

AUM at September 30, 2014 was $707.8 billion, an increase of $6.0 billion, or 1%, from March 31, 2014. The increase in AUM was attributable to net client inflows of $5.1 billion, the positive impact of market performance and other of $8.7 billion, and $5.0 billion related to the acquisition of QS Investors, offset in part by the reclassification of $12.8 billion of client assets from AUM to AUA, which is reflected in market performance and other, as previously discussed. Market performance and other also includes $5.8 billion resulting from the negative impact of foreign currency exchange fluctuations. There were $3.7 billion of net client inflows into the liquidity asset class, primarily into low-fee money market funds, and $1.4 billion of net client inflows into long-term asset classes, with fixed income net inflows of $1.6 billion partially offset by equity net outflows of $0.2 billion. Fixed income net inflows were primarily in products managed by Brandywine, and were offset in part by net outflows in products managed by Western Asset. Equity net outflows were primarily in products managed at Royce and QS Investors, which includes legacy Batterymarch, partially offset by net inflows at ClearBridge and Brandywine.

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

	2014	% of Total	2013	% of Total	% Change
Equity	$191.4	28 %	$165.4	25 %	16 %
Fixed Income	363.4	52	357.9	55	2
Liquidity	142.0	20	130.4	20	9
Total	$696.8	100 %	$653.7	100 %	7 %

The component changes in our AUM by asset class (in billions) for the six months ended September 30, 2014 and 2013, were as follows:

	Equity	Fixed Income	Liquidity	Total
March 31, 2014	$186.4	$365.2	$150.2	$701.8
Investment funds, excluding liquidity funds				
Subscriptions	13.7	18.6	—	32.3
Redemptions	(15.8)	(13.3)	—	(29.1)
Separate account flows, net	1.9	(3.7)	(0.2)	(2.0)
Liquidity fund flows, net	—	—	3.9	3.9
Net client cash flows	(0.2)	1.6	3.7	5.1
Market performance and other	3.1	(7.1)	(0.1)	(4.1)
Acquisition	4.3	0.7	—	5.0
September 30, 2014	$193.6	$360.4	$153.8	$707.8

	Equity	Fixed Income	Liquidity	Total
March 31, 2013	$161.8	$365.1	$137.7	$664.6
Investment funds, excluding liquidity funds				
Subscriptions	13.2	13.4	—	26.6
Redemptions	(14.8)	(16.0)	—	(30.8)
Separate account flows, net	(3.1)	3.8	(0.8)	(0.1)
Liquidity fund flows, net	—	—	(5.6)	(5.6)
Net client cash flows	(4.7)	1.2	(6.4)	(9.9)
Market performance and other	13.7	(11.3)	0.2	2.6
Disposition	(1.3)	—	—	(1.3)
September 30, 2013	$169.5	$355.0	$131.5	$656.0

AUM by Distribution Channel

The component changes in our AUM by distribution channel (in billions) for the six months ended September 30, 2014 and 2013, were as follows:

	Global Distribution	Affiliate/Other	Total
March 31, 2014	$247.4	$454.4	$701.8
Net client cash flows, excluding liquidity funds	5.8	(4.6)	1.2
Liquidity fund flows, net	—	3.9	3.9
Net client cash flows	5.8	(0.7)	5.1
Market performance and other	3.3	(7.4)	(4.1)
Acquisition	—	5.0	5.0
September 30, 2014	$256.5	$451.3	$707.8

	Global Distribution	Affiliate/Other	Total
March 31, 2013	$232.1	$432.5	$664.6
Net client cash flows, excluding liquidity funds	(3.4)	(0.9)	(4.3)
Liquidity fund flows, net	—	(5.6)	(5.6)
Net client cash flows	(3.4)	(6.5)	(9.9)
Market performance and other	6.3	(3.7)	2.6
Disposition	—	(1.3)	(1.3)
September 30, 2013	$235.0	$421.0	$656.0

Assets Under Advisement

As of September 30, 2014, AUA was $117.3 billion. During the six months ended September 30, 2014, we began reporting AUA as a result of the acquisition of QS Investors with AUA of $98.3 billion. AUA also includes $11.5 billion of existing client assets previously reported as AUM that were reclassified to AUA, primarily related to a low-fee global sovereign mandate for which investment discretion has abated over time.

Results of Operations

Operating Revenues

The components of Total Operating Revenues (in millions), and the dollar and percentage changes between periods were as follows:

	Six Months Ended September 30,			
	2014	2013	$ Change	% Change
Investment advisory fees:				
Separate accounts	$409.5	$382.7	$26.8	7%
Funds	770.9	743.1	27.8	4
Performance fees	30.3	39.4	(9.1)	(23)
Distribution and service fees	184.2	171.1	13.1	8
Other	2.9	4.0	(1.1)	(28)
Total Operating Revenues	$1,397.8	$1,340.3	$57.5	4%

Total operating revenues for the six months ended September 30, 2014, were $1.40 billion, an increase of 4% from $1.34 billion for the six months ended September 30, 2013. This increase was primarily due to the impact of a 6% increase in average long-term AUM, offset in part by a decrease in performance fees. Average AUM advisory revenue yields were 34 basis points in both the six months ended September 30, 2014 and 2013. There was a slight decrease in average AUM advisory revenue yields as the result of a less favorable product mix, with lower yielding products comprising a higher percentage of our total average AUM for the six months ended September 30, 2014, as compared to the six months ended September 30, 2013.

Investment advisory fees from separate accounts increased $26.8 million, or 7%, to $409.5 million, as compared to $382.7 million for the six months ended September 30, 2013. Of this increase, $17.3 million was the result of higher average equity assets managed by ClearBridge and Brandywine and $14.1 million was due to higher average fixed income assets managed by Western Asset and Brandywine. These increases were offset in part by a decrease of $6.3 million due to lower average equity assets managed by QS Investors, including those previously managed by legacy Batterymarch, which is being integrated over time into QS Investors.

Investment advisory fees from funds increased $27.8 million, or 4%, to $770.9 million, as compared to $743.1 million for the six months ended September 30, 2013. Of this increase, $49.5 million was due to higher average equity assets managed by ClearBridge, offset in part by a decrease of $14.7 million due to lower average assets managed by Permal and $7.3 million due to lower average fixed income assets managed by Western Asset.

Performance fees decreased $9.1 million, or 23%, to $30.3 million, as compared to $39.4 million for the six months ended September 30, 2013, primarily due to lower fees earned on assets managed by Western Asset and Permal.

Distribution and service fees increased $13.1 million, or 8%, to $184.2 million, as compared to $171.1 million for the three months ended September 30, 2013. In connection with the acquisition of QS Investors and its related AUA, as well as the reclassification of certain existing client assets from AUM to AUA during the six months ended September 30, 2014, as previously discussed, approximately $11.2 million of revenues related to these client assets are now included in Distribution and service fees for fiscal 2015.

Operating Expenses

The components of Total Operating Expenses (in millions), and the dollar and percentage changes between periods were as follows:

	Six Months Ended September 30,					
	2014	2013	$ Change		% Change	
Compensation and benefits	$609.4	$590.4	$19.0		3	%
Distribution and servicing	303.8	325.3	(21.5	)	(7	)
Communications and technology	86.5	78.4	8.1		10	
Occupancy	49.7	51.7	(2.0	)	(4	)
Amortization of intangible assets	1.4	7.3	(5.9	)	(81	)
Other	97.1	97.3	(0.2	)	—	
Total Operating Expenses	$1,147.9	$1,150.4	$(2.5	)	—	%

Operating expenses for the six months ended September 30, 2014 and 2013, incurred at the investment management affiliate level comprised approximately 70% of total operating expenses in each year. The remaining operating expenses are comprised of corporate and distribution costs.

The components of Compensation and benefits (in millions) for the six months ended September 30 were as follows:

	Six Months Ended September 30,					
	2014	2013	$ Change		% Change	
Salaries and incentives	$472.7	$461.1	$11.6		3	%
Benefits and payroll taxes (including deferred compensation)	111.2	110.4	0.8		1	
Transition costs and severance	21.4	12.9	8.5		66	
Gains on deferred compensation and seed capital investments	4.1	6.0	(1.9	)	(32	)
Compensation and benefits	$609.4	$590.4	$19.0		3	%

Compensation and benefits increased 3% to $609.4 million for the six months ended September 30, 2014, as compared to $590.4 million for the six months ended September 30, 2013, as a result of the following:

- Salaries and incentives increased $11.6 million, to $472.7 million, as compared to $461.1 million for the six months ended September 30, 2013, principally due to a $4.6 million increase in net compensation at investment affiliates, primarily due to the impact of increased revenues at certain revenue share-based affiliates, and a $5.0 million increase in incentive compensation expense for distribution and corporate personnel.

- Benefits and payroll taxes increased slightly to $111.2 million, as compared to $110.4 million for the six months ended September 30, 2013, primarily as a result of an increase in health insurance and recruiting costs.

- Transition costs and severance increased $8.5 million, to $21.4 million, as compared to $12.9 million for the six months ended September 30, 2013, primarily due to higher compensation costs associated with the previously

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discussed integration of Batterymarch and LMGAA over time into QS Investors, as compared to compensation costs associated with various corporate initiatives recognized in the prior year period.

- Gains on deferred compensation and seed capital investments for the six months ended September 30, 2014 were$4.1 million, as compared to gains of $6.0 million for the six months ended September 30, 2013. The decrease was primarily due to a reduction in net market gains on assets invested for deferred compensation plans and seed capital investments.

Compensation as a percentage of operating revenues decreased to 43.6% from 44.0%, due to the impact of compensation decreases related to a reduction in net market gains on assets invested for deferred compensation plans and seed capital investments.

Distribution and servicing expenses decreased 7% to $303.8 million, as compared to $325.3 million for the six months ended September 30, 2013, primarily due to a net decrease in structuring fees related to closed-end fund launches of $20.9 million.

Communications and technology expense increased 10% to $86.5 million, as compared to $78.4 million for the six months ended September 30, 2013, primarily as a result of an increase in technology consulting, depreciation and data management expenses.

Occupancy expense decreased 4% to $49.7 million, as compared to $51.7 million for the six months ended September 30, 2013, primarily due to reductions in lease reserves of $4.5 million recorded in the current year period, as compared to $2.8 million of similar adjustments recorded in the prior year period.

Amortization of intangible assets decreased 81% to $1.4 million, as compared to $7.3 million for the six months ended September 30, 2013, primarily due to certain management contracts becoming fully amortized in December 2013 and the reclassification of certain asset management contracts to assets held for sale in connection with the sale of LMIC.

Other expenses remained essentially flat at $97.1 million, as compared to $97.3 million for the six months ended September 30, 2013, as a $2.0 million decrease in losses due to foreign exchange fluctuations was substantially offset by a $1.6 million increase in travel and entertainment expenses.

Non-Operating Income (Expense)

The components of Total Other Non-Operating Income (Expense) (in millions), and the dollar and percentage changes between periods were as follows:

	Six Months Ended September 30,			
	2014	2013	$ Change	% Change
Interest income	$4.2	$3.0	$1.2	40 %
Interest expense	(32.0)	(25.9)	(6.1)	24
Other income (expense), net, including $107.1 million debt extinguishment loss in July 2014	(101.9)	9.7	(111.6)	n/m
Other non-operating income of consolidated investment vehicles, net	2.9	5.0	(2.1)	(42)%
Total Other Non-Operating Income (Expense)	$(126.8)	$(8.2)	$(118.6)	n/m

n/m - not meaningful

Interest income increased 40% to $4.2 million, as compared to $3.0 million for the six months ended September 30, 2013, primarily due to $0.7 million of interest income received in 2014 in connection with a tax refund, as well as higher yields earned on investment balances.

Interest expense increased 24% to $32.0 million, as compared to $25.9 million for the six months ended September 30, 2013, primarily due to the impact of refinancing the five-year term loan in January 2014 and the 5.5% Senior Notes, which was finalized in July 2014.

Other income (expense), net, decreased $111.6 million, to expense of $101.9 million, as compared to income of $9.7 million for the six months ended September 30, 2013. This decrease was primarily due to a $107.1 million charge related to the refinancing of the 5.5% Senior Notes during the six months ended September 30, 2014. A reduction in net market gains of $4.8 million on corporate investments, which are not offset in compensation, and a reduction in net market gains of $1.9 million on seed capital investments and assets invested for deferred compensation plans, which are offset by corresponding decreases in compensation mentioned above, also contributed to the decrease.

Other non-operating income of CIVs, net, decreased $2.1 million to $2.9 million, primarily due to the deconsolidation of a collateralized loan obligation in the quarter ended June 30, 2014.

Income Tax Provision

For the six months ended September 30, 2014, the provision for income taxes was $44.5 million, as compared to $44.9 million in the six months ended September 30, 2013. The effective tax rate was 36.1% for the six months ended September 30, 2014, as compared to 24.7% for the six months ended September 30, 2013. The impact of the tax rate changes in the Finance Bill 2013 on certain existing deferred tax assets and liabilities resulted in tax benefits of $19.2 million, and impacted the effective tax rate by 10.5 percentage points, in the six months ended September 30, 2013. The increase in the effective tax rate for the six months ended September 30, 2014, was primarily related to the impact of the U.K. tax rate changes in the prior year period. The impact of CIVs reduced the effective tax rate by 0.4 percentage points in both the six months ended September 30, 2014 and 2013.

Net Income Attributable to Legg Mason, Inc. and Operating Margin

Net Income Attributable to Legg Mason, Inc. for the six months ended September 30, 2014, totaled $77.1 million, or $0.66 per diluted share, as compared to $134.1 million, or $1.08 per diluted share, in the six months ended September 30, 2013. The decrease was primarily attributable to the pre-tax, non-operating charge of $107.1 million ($68.5 million, net of income tax benefits, or $0.58 per diluted share) related to the refinancing of the 5.5% Senior Notes in the six months ended September 30, 2014, offset in part by a $20.7 million net decrease in costs related to closed-end fund launches, and the net impact of increased operating revenues. Operating margin was 17.9% for the six months ended September 30, 2014, as compared to 14.2% for the six months ended September 30, 2013.

Supplemental Non-GAAP Financial Information

Adjusted Income (see Supplemental Non-GAAP Financial Information below) decreased to $147.8 million, or $1.26 per diluted share, for the six months ended September 30, 2014, from $189.7 million, or $1.53 per diluted share, for the six months ended September 30, 2013, primarily due to the pre-tax, non-operating charge of $107.1 million ($68.5 million, net of income tax benefits, or $0.58 per diluted share) related to the refinancing of the 5.5% Senior Notes and the net impact of increased operating revenues. Operating Margin, as Adjusted (see Supplemental Non-GAAP Financial Information below), for the six months ended September 30, 2014 and 2013, was 23.4% and 20.1%, respectively. Operating Margin, as Adjusted, for the six months ended September 30, 2014, was reduced by 2.1 percentage points due to costs associated with the integration of Batterymarch and LMGAA over time into QS Investors and various other corporate initiatives, while Operating Margin, as Adjusted, for the six months ended September 30, 2014 and 2013, was reduced by 0.4 percentage points and 2.1 percentage points, respectively, due to costs related to closed-end fund launches during each of those periods.

Quarter Ended September 30, 2014, Compared to Quarter Ended June 30, 2014

Results of Operations

Net Income Attributable to Legg Mason, Inc. for the three months ended September 30, 2014, was $4.9 million, or $0.04 per diluted share, as compared to $72.2 million, or $0.61 per diluted share, in the three months ended June 30, 2014. This decrease was primarily attributable to the $107.1 million ($68.5 million, net of income tax benefits, or $0.59 per diluted share) non-operating charge related to the refinancing of the 5.5% Senior Notes initiated in the prior quarter and finalized in July 2014 (See Note 7 of Notes to Consolidated Financial Statements for additional information). Operating revenues increased to $703.9 million in the three months ended September 30, 2014, as compared to $693.9 million in the three months ended June 30, 2014. The increase in operating revenues was primarily due to an increase in average long-term AUM and the impact of one additional day in the three months ended September 30, 2014.

Operating expenses were relatively flat at $573.5 million in the three months ended September 30, 2014, as compared to $574.3 million in the three months ended June 30, 2014. The three months ended September 30, 2014, included $8.7 million in costs related to the integration of Batterymarch and LMGAA over time into QS Investors and various other corporate initiatives, as compared to $14.4 million of such costs in the three months ended June 30, 2014. In addition, the three months ended September 30, 2014, included $5.6 million of costs related to a closed-end fund launch, which were substantially offset by the impact of a $4.5 million adjustment to lease reserves.

Other non-operating expense increased $116.2 million, from $5.3 million for the three months ended June 30, 2014, to $121.5 million for the three months ended September 30, 2014. The increase was primarily attributable to the $107.1 million charge related to our debt restructuring, as previously discussed. Operating margin was 18.5% for the three months ended September 30, 2014, as compared to 17.2% for the three months ended June 30, 2014.

Adjusted Income (see Supplemental Non-GAAP Financial Information below) was $40.6 million, or $0.35 per diluted share, for the three months ended September 30, 2014, as compared to $107.2 million, or $0.91 per diluted share, for the three months ended June 30, 2014. Operating Margin, as Adjusted (see Supplemental Non-GAAP Financial Information below), for the three months ended September 30, 2014 and June 30, 2014, was 23.8% and 22.9%, respectively. Operating Margin, as Adjusted, was reduced by 1.6 percentage points and 2.5 percentage points for the three months ended September 30, 2014 and June 30, 2014, respectively, due to costs associated with the integration of Batterymarch and LMGAA over time into QS Investors and various other corporate initiatives. In addition, Operating Margin, as Adjusted, for the three months ended September 30, 2014, was reduced by 0.8 percentage points due to costs associated with a closed-end fund launch during the period.

Supplemental Non-GAAP Financial Information
As supplemental information, we are providing performance measures that are based on methodologies other than generally accepted accounting principles (“non-GAAP”) for "Adjusted Income" and "Operating Margin, as Adjusted" that management uses as benchmarks in evaluating and comparing our period-to-period operating performance.

Adjusted Income
We define "Adjusted Income" as Net Income Attributable to Legg Mason, Inc., plus amortization and deferred taxes related to intangible assets and goodwill, imputed interest and tax benefits on contingent convertible debt less deferred income taxes on goodwill and indefinite-life intangible asset impairment, if any. We also adjust for non-core items that are not reflective of our economic performance, such as intangible asset impairments, the impact of fair value adjustments of contingent consideration liabilities, if any, the impact of tax rate adjustments on certain deferred tax liabilities related to indefinite-life intangible assets, and loss on extinguishment of contingent convertible debt.

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

Adjusted Income only considers adjustments for certain items that relate to operating performance and comparability, and therefore, is most readily reconcilable to Net Income Attributable to Legg Mason, Inc. determined under GAAP. This measure is provided in addition to Net Income Attributable to Legg Mason, Inc., but is not a substitute for Net Income Attributable to Legg Mason, Inc. and may not be comparable to non-GAAP performance measures, including measures of adjusted earnings or adjusted income, of other companies. Further, Adjusted Income is not a liquidity measure and should not be used in place of cash flow measures determined under GAAP. Fair value adjustments of contingent consideration liabilities may or may not provide a tax benefit, depending on the tax attributes of the acquisition transaction. We consider Adjusted Income to be useful to investors because it is an important metric in measuring the economic performance of asset management companies, as an indicator of value, and because it facilitates comparison of our operating results with the results of other asset management firms that have not issued/extinguished contingent convertible debt or made significant acquisitions.

In calculating Adjusted Income, we adjust for the impact of the amortization of management contract assets and impairment of indefinite-life intangible assets, and add (subtract) the impact of fair value adjustments of contingent consideration liabilities, if any, all of which arise from acquisitions, to Net Income Attributable to Legg Mason, Inc. to reflect the fact that these items distort comparisons of our operating results with the results of other asset management firms that have not engaged in significant acquisitions. Deferred taxes on indefinite-life intangible assets and goodwill include actual tax benefits from amortization deductions that are not realized under GAAP absent an impairment charge or the disposition of the related business. Because we fully expect to realize the economic benefit of the current period tax amortization, we add this benefit to Net Income Attributable to Legg Mason, Inc. in the calculation of Adjusted Income. However, because of our net operating loss carry-forward, we will receive the benefit of the current tax amortization over time. Conversely, we subtract the non-cash income tax benefits on goodwill and indefinite-life intangible asset impairment charges and U.K. tax rate adjustments on excess book basis on certain acquired indefinite-life intangible assets, if applicable, that have been recognized under GAAP. We also add back, if applicable, non-cash imputed interest and the extinguishment loss on contingent convertible debt adjusted for amounts allocated to the conversion feature, as well as adding the actual tax benefits on the imputed interest that are not realized under GAAP. These adjustments reflect that these items distort comparisons of our operating results to prior periods and the results of other asset management firms that have not engaged in significant acquisitions, including any related impairments, or issued/extinguished contingent convertible debt.

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

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

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

	Three Months Ended		
	September 30, 2014	June 30, 2014	September 30, 2013
Net Income Attributable to Legg Mason, Inc.	$4,897	$72,188	$86,288
Plus (less):			
Amortization of intangible assets	464	895	3,624
Deferred income taxes on intangible assets:			
Tax amortization benefit	35,225	34,144	33,737
U.K. tax rate adjustment	—	—	(19,164)
Adjusted Income	$40,586	$107,227	$104,485
Net Income per diluted share Attributable to Legg Mason, Inc. common shareholders	$0.04	$0.61	$0.70
Plus (less):			
Amortization of intangible assets	—	—	0.03
Deferred income taxes on intangible assets:			
Tax amortization benefit	0.31	0.30	0.28
U.K. tax rate adjustment	—	—	(0.16)
Adjusted Income per diluted share	$0.35	$0.91	$0.85

	Six Months Ended	
	September 30, 2014	September 30, 2013
Net Income Attributable to Legg Mason, Inc.	$77,085	$134,103
Plus (less):		
Amortization of intangible assets	1,359	7,248
Deferred income taxes on intangible assets:		
Tax amortization benefit	69,369	67,473
U.K. tax rate adjustment	—	(19,164)
Adjusted Income	$147,813	$189,660
Net Income per diluted share Attributable to Legg Mason, Inc. common shareholders	$0.66	$1.08
Plus (less):		
Amortization of intangible assets	0.01	0.06
Deferred income taxes on intangible assets:		
Tax amortization benefit	0.59	0.54
U.K. tax rate adjustment	—	(0.15)
Adjusted Income per diluted share	$1.26	$1.53

Operating Margin, as Adjusted

We calculate "Operating Margin, as Adjusted," by dividing (i) Operating Income, adjusted to exclude the impact on compensation expense of gains or losses on investments made to fund deferred compensation plans, the impact on compensation expense of gains or losses on seed capital investments by our affiliates under revenue sharing agreements, amortization related to intangible assets, income (loss) of CIVs, the impact of fair value adjustments of contingent consideration liabilities, if any, and impairment charges by (ii) our operating revenues, adjusted to add back net investment advisory fees eliminated upon consolidation of investment vehicles, less distribution and servicing expenses which we use as an approximate measure of revenues that are passed through to third parties, which we refer to as "Operating Revenues, as Adjusted." The compensation items are removed from Operating Income in the calculation because they are offset by an equal amount in Other non-operating income (expense), and thus have no impact on Net Income Attributable to Legg Mason, Inc. We adjust for the impact of the amortization of management contract assets and the impact of fair value adjustments of contingent consideration liabilities, if any, which arise from acquisitions to reflect the fact that these items distort comparison of our operating results with results of other asset management firms that have not engaged in significant acquisitions. Impairment charges and income (loss) of CIVs are removed from Operating Income in the calculation because these items are not reflective of our core asset management operations. We use Operating Revenues, as Adjusted in the calculation to show the operating margin without distribution and servicing expenses, which we use to approximate our distribution revenues that are passed through to third parties as a direct cost of selling our products, although distribution and servicing expenses may include commissions paid in connection with the launching of closed-end funds for which there is no corresponding revenue in the period. Operating Revenues, as Adjusted, also include our advisory revenues we receive from CIVs that are eliminated in consolidation under GAAP.

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

The calculation of Operating Margin and Operating Margin, as Adjusted, is as follows (dollars in thousands):

	Three Months Ended		
	September 30, 2014	June 30, 2014	September 30, 2013
Operating Revenues, GAAP basis	$703,895	$693,881	$669,852
Plus (less):			
Operating revenues eliminated upon consolidation of investment vehicles	184	183	523
Distribution and servicing expense excluding consolidated investment vehicles	(155,090)	(148,701)	(155,134)
Operating Revenues, as Adjusted	$548,989	$545,363	$515,241
Operating Income, GAAP basis	$130,355	$119,546	$106,366
Plus (less):			
Gains (losses) on deferred compensation and seed investments	(374)	4,449	4,176
Amortization of intangible assets	464	895	3,624
Operating income of consolidated investment vehicles, net	238	203	648
Operating Income, as Adjusted	$130,683	$125,093	$114,814
Operating Margin, GAAP basis	18.5 %	17.2 %	15.9 %
Operating Margin, as Adjusted	23.8	22.9	22.3

	Six Months Ended	
	September 30, 2014	September 30, 2013
Operating Revenues, GAAP basis	$1,397,776	$1,340,269
Plus (less):		
Operating revenues eliminated upon consolidation of investment vehicles	367	1,138
Distribution and servicing expense excluding consolidated investment vehicles	(303,791)	(325,309)
Operating Revenues, as Adjusted	$1,094,352	$1,016,098
Operating Income, GAAP basis	$249,901	$189,900
Plus:		
Gains on deferred compensation and seed investments	4,075	6,048
Amortization of intangible assets	1,359	7,248
Operating income of consolidated investment vehicles, net	441	1,320
Operating Income, as Adjusted	$255,776	$204,516
Operating Margin, GAAP basis	17.9 %	14.2 %
Operating Margin, as Adjusted	23.4	20.1

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

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

Our assets consist primarily of intangible assets, goodwill, cash and cash equivalents, investment securities, and investment advisory and related fee receivables. Our assets have been principally funded by equity capital, long-term debt and the results of our operations. At September 30, 2014, cash and cash equivalents, total assets, long-term debt and stockholders' equity were $0.7 billion, $6.8 billion, $1.1 billion and $4.6 billion, respectively. Total assets include amounts related to CIVs of $0.1 billion.

Cash and cash equivalents are primarily invested in liquid domestic and non-domestic money market funds that hold principally domestic and non-domestic corporate commercial paper and bonds, government and agency securities, and bank deposits. We have not recognized any losses on these investments. Our monitoring of cash and cash equivalents mitigates the potential that material risks may be associated with these balances.

The following table summarizes our Consolidated Statements of Cash Flows for the six months ended September 30 (in millions):

	2014	2013
Cash flows provided by operating activities	$131.6	$100.2
Cash flows provided by (used in) investing activities	(28.1)	56.8
Cash flows used in financing activities	(290.1)	(367.5)
Effect of exchange rate changes	(12.4)	(10.6)
Net change in cash and cash equivalents	(199.0)	(221.1)
Cash and cash equivalents, beginning of period	858.0	933.0
Cash and cash equivalents, end of period	$659.0	$711.9

Cash inflows provided by operating activities during the six months ended September 30, 2014, were $131.6 million, primarily related to net sales of trading and other current investments and Net Income, adjusted for non-cash items, offset in part by net annual payments for accrued and deferred compensation. Cash inflows provided by operating activities during the six months ended September 30, 2013, were $100.2 million, primarily related to Net Income, adjusted for non-cash items, offset in part by net annual payments for accrued compensation and net purchases of trading and other current investments.

Cash outflows used in investing activities during the six months ended September 30, 2014, were $28.1 million, primarily related to payments for fixed assets and the acquisition of QS Investors. Cash inflows provided by investing activities during the six months ended September 30, 2013, were $56.8 million, primarily related to net activity related to CIVs of $80.7 million, offset in part by payments made for fixed assets.

Cash outflows used in financing activities during the six months ended September 30, 2014, were $290.1 million, primarily related to the repayment of long-term debt of $645.6 million, the repurchase of 3.7 million shares of our common stock for $180.0 million, the repayment of long-term debt of CIVs of $79.2 million, and dividends paid of $34.8 million, offset in part by the proceeds from the issuance of $658.8 million of long-term debt. Cash outflows used in financing activities during the six months ended September 30, 2013, were $367.5 million, primarily related to the repurchase of 5.3 million shares of our common stock for $179.9 million, net activity related to CIVs of $106.5 million, the repayment of long-term debt of $50.2 million, and dividends paid of $30.4 million.

In June 2014, we issued $250 million of 2.7% Senior Notes due 2019 at a discount of $0.6 million, $250 million of 3.95% Senior Notes due 2024 at a discount of $0.5 million, and an additional $150 million of 5.625% Senior Notes due 2044 at a premium of $9.8 million. In July 2014, these proceeds of $659 million, together with cash on hand, were used to redeem the outstanding $650 million of 5.5% Senior Notes due 2019 (the "Existing 2019 Notes"). The retirement of the Existing 2019 Notes resulted in a pre-tax, non-operating charge of $107.1 million in July 2014, consisting of a make-whole premium payment of $98.6 million, net of $0.6 million from a reverse treasury lock, to call the Existing 2019 Notes and $8.5 million associated with existing deferred costs and original issue discount. We expect to realize over $10 million in interest expense savings from these transactions over the next 12 months, with additional annual interest savings over the life of the new debt.

We expect that over the next 12 months cash generated from our operating activities and available cash on hand will be adequate to support our operating and investing cash needs, and planned share repurchases. In addition to our ordinary operating cash needs, we anticipate other cash needs during the next 12 months, as discussed below.

We currently intend to utilize our other available resources for any number of potential activities, including, but not limited to, seed capital investments in new products, repurchase of shares of our common stock, acquisitions, repayment of outstanding debt, or payment of increased dividends.

In March 2015, we may be required to pay up to $24 million (using the exchange rate as of September 30, 2014 for the £15 million maximum contractual amount) under the agreements governing the acquisition of Fauchier Partners Management Limited, with the amount of the payment dependent on the achievement of certain levels of revenue, net of distribution costs. We intend to fund any amount due with existing cash resources.

In connection with the integration over time of two existing affiliates, Batterymarch and LMGAA, with QS Investors, we expect to incur total restructuring and transition costs of up to approximately $40 million, of which approximately 25% are non-cash charges. Approximately $25 million of these charges have been accrued to date, and approximately $10 million have been paid to date. The significant portion of the remaining unpaid total costs will be paid during the remainder of fiscal 2015. See Note 3 of Notes to Consolidated Financial Statements for additional information.

Effective May 31, 2014, we completed the acquisition of QS Investors. The transaction included an initial cash payment of $11 million, which was funded from existing cash resources. In addition, contingent consideration of up to $10 million and $20 million for the second and fourth anniversary payments may be due in July 2016 and July 2018, respectively, dependent on the achievement of certain net revenue targets, and subject to a potential catch-up adjustment in the fourth anniversary payment for any second anniversary payment shortfall. The contingent consideration liability established at closing had an acquisition date fair value of $13.4 million, and has accreted to $13.5 million as of September 30, 2014.

On October 1, 2014, we acquired all outstanding equity interests of Martin Currie (Holdings) Limited. The acquisition required an initial payment of approximately $202 million (using the foreign exchange rate as of October 1, 2014 for the £125 million per the contract), which we funded from existing cash resources. In addition, contingent consideration may be payable after March 31 following the first, second and third anniversaries of closing, aggregating up to approximately $527 million (using the foreign exchange rate as of September 30, 2014 for the maximum £325 million contractual amount), inclusive of the payment of certain potential obligations, and dependent on the achievement by Martin Currie of certain financial thresholds.

In June 2013 and March 2014, we implemented management equity plans that will entitle certain key employees of Permal and ClearBridge, respectively, to participate in 15% of the future growth of the respective enterprise value (subject to appropriate discounts), if any. Repurchases of units granted under the plans may impact future liquidity requirements.

As described above, we currently project that our cash flows from operating activities and available cash on hand will be sufficient to fund our liquidity needs over the next 12 months. As of September 30, 2014, excluding the $202 million used for the initial payment for the acquisition of Martin Currie on October 1, 2014, we had over $170 million in cash and cash equivalents in excess of our minimum operating cash requirements. In accordance with our capital plan, we intend to utilize up to 65% of cash generated from future operations to purchase shares of our common stock. As of September 30, 2014, we also had undrawn revolving credit facilities totaling $750 million, expiring June 2017. We do not currently expect to raise additional debt or equity financing over the next 12 months. However, there can be no assurances of these expectations as our projections could prove to be incorrect, events may occur that require additional liquidity in excess of amounts available under our revolving credit facilities, such as an acquisition opportunity or an opportunity to refinance indebtedness, or market conditions might significantly worsen, affecting our results of operations and generation of available cash. If these events result in our operations and available cash being insufficient to fund liquidity needs, we would likely seek to manage our available resources by taking actions such as reducing future share repurchases, reducing operating expenses, reducing our expected funding of investments, selling assets (such as investment securities), repatriating earnings from foreign subsidiaries, or modifying arrangements with our affiliates and/or employees. Should these types of actions prove insufficient, or should a large acquisition or refinancing opportunity arise, we may seek to raise additional equity or debt.

At September 30, 2014, our total cash and cash equivalents of $659 million included $208 million held by foreign subsidiaries. In prior years, we executed our various plans to repatriate accumulated foreign earnings. No further repatriation of accumulated foreign earnings is currently planned. However, if circumstances change, we will provide for and pay any applicable U.S. taxes in connection with any further repatriation of offshore funds. It is not practical at this time to determine the income tax liability that would result from any further repatriation of accumulated foreign earnings.

As of September 30, 2014, approximately 2% of total assets (14% of financial assets at fair value) and approximately 2% of total liabilities (14% of financial liabilities measured at fair value) meet the definition of Level 3. Excluding the assets and liabilities of CIVs, approximately 1% of total assets (9% of financial assets measured at fair value) and 2% of total liabilities (14% of financial liabilities measured at fair value) meet the definition of Level 3.

On October 28, 2014, the Board of Directors approved a regular quarterly cash dividend in the amount of $0.16 per share, payable on January 12, 2015.

Contractual and Contingent Obligations

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

The following table sets forth these contractual obligations (in millions) by fiscal year, and excludes contractual obligations of CIVs, as we are not responsible or liable for these obligations:

	Remaining 2015	2016	2017	2018	2019	Thereafter	Total
Contractual Obligations							
Long-term borrowings by contract maturity	$ 0.2	$—	$—	$—	$—	$1,050.0	$1,050.2
Interest on long-term borrowings and credit facility commitment fees	25.5	49.1	49.1	48.0	47.6	831.1	1,050.4
Minimum rental and service commitments	69.7	123.3	104.6	90.7	76.5	352.1	816.9
Total Contractual Obligations	95.4	172.4	153.7	138.7	124.1	2,233.2	2,917.5
Contingent Obligations							
Payments related to business acquisitions(1)							
Martin Currie	202.0	527.0	—	—	—	—	729.0
Other(2)	24.0	—	42.0	—	20.0	—	86.0
Total payments related to business acquisitions	226.0	527.0	42.0	—	20.0	—	815.0
Total Contractual and Contingent Obligations(3)(4)(5)(6)	$ 321.4	$699.4	$195.7	$138.7	$144.1	$2,233.2	$3,732.5

(1) The amount of contingent payments reflected for any year represents the maximum amount that could be payable at the earliest possible date under the terms of the business purchase agreements, using the applicable exchange rate for amounts denominated in other than the U.S. dollar. See Note 9 of Notes to Consolidated Financial Statements.

(2) The contingent obligations, excluding amounts from the Martin Currie acquisition which closed on October 1, 2014, had a fair value of $42.7 million as of September 30, 2014.

(3) The table above does not include approximately $33.5 million in capital commitments to investment partnerships in which Legg Mason is a limited partner. These obligations will be outstanding, or funded as required, through the end of the commitment periods running through fiscal 2021.

(4) The table above does not include amounts for uncertain tax positions of $60.4 million (net of the federal benefit for state tax liabilities), because the timing of any related cash outflows cannot be reliably estimated.

(5) The table above does not include redeemable noncontrolling interests, primarily related to CIVs, of $47.4 million, because the timing of any related cash outflows cannot be reliably estimated.

(6) The table above excludes potential obligations arising from the ultimate settlement of awards under the management equity plans with key employees of Permal and ClearBridge due to the uncertainty of the timing and amounts ultimately payable. See Note 8 of Notes to Consolidated Financial Statements for additional information regarding management equity plans.

Recent Accounting Developments

See discussion of Recent Accounting Developments in Note 2 of Notes to Consolidated Financial Statements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

During the six months ended September 30, 2014, there were no material changes to the information contained in Part II, Item 7A of Legg Mason’s Annual Report on Form 10-K for the fiscal year ended March 31, 2014.

Item 4. Controls and Procedures

As of September 30, 2014, Legg Mason's management, including the Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of the design and operation of Legg Mason's disclosure controls and procedures. In evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on that evaluation, Legg Mason's management, including its Chief Executive Officer and its Chief Financial Officer, concluded that Legg Mason's disclosure controls and procedures were effective on a reasonable assurances basis. There have been no changes in Legg Mason's internal controls over financial reporting that occurred during the quarter ended September 30, 2014, that have materially affected, or are reasonably likely to materially affect, Legg Mason's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1A. Risk Factors

The following is an update to the risk factors set forth in our Report on Form 10-K for the fiscal year ended March 31, 2014. The risk factor below has been updated to include activity for the six months ended September 30, 2014.

U.S. Regulatory Action Impacting Money Market Funds May Negatively Affect our Business and Results of Operations.

On July 23, 2014, the U.S. Securities and Exchange Commission voted to approve amendments to Rule 2a-7 of the Investment Company Act of 1940, which governs money market funds. Under the new rule, institutional prime and institutional municipal money market funds will be required to maintain a market-based, or floating, net asset value ("NAV") share price for sales and redemptions based on the current market value of the securities in their portfolios. As a result, once the new rules are in effect, daily share prices of these money market funds will fluctuate along with changes, if any, in the market-based value of their underlying portfolio securities. Money market funds qualifying as either government or retail funds as defined in the amendments will be exempt from the floating NAV requirements and will continue to be allowed to use the amortized cost method of pricing to seek to maintain a stable $1.00 NAV. The new amendments also allow money market fund boards of directors to impose liquidity fees or to temporarily suspend redemptions if a fund's weekly liquid assets fall below a certain threshold. The rule also includes additional requirements, including increased disclosure and reporting, immediate reporting of certain fund and portfolio events, tighter diversification requirements, and enhanced stress-testing measures.

There will be a multi-year implementation for these rules, with the compliance date for the floating NAV amendments and liquidity fees and gates amendments described above occurring in mid-2016, and for other amendments phasing in earlier in either mid-2015 or early 2016.

Approximately 22% of our assets under management as of September 30, 2014, consisted of assets in money market funds, of which institutional prime or institutional municipal money market funds (including offshore funds that feed into such money market funds) comprised approximately 84%. We are in the process of considering the impact of these regulations on the money market fund industry and determining what actions, if any, we should take in response to the impact these new regulations may have on our business. Among other things, the new regulations could reduce the attractiveness of money market funds to retail and institutional investors and raise the costs of being in this business. Any of these regulatory changes could adversely affect our business and our results of operations.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table sets out information regarding our purchases of Legg Mason common stock in each month during the quarter ended September 30, 2014:

Period	Total number of shares purchased (1)	Average price paid per share (1)(2)	Total number of shares purchased as part of publicly announced plans or programs(3)	Approximate dollar value that may yet be purchased under the plans or programs(3)
July 1, 2014 through July 31, 2014	395,087	$50.68	394,637	$259,937,576
August 1, 2014 through August 31, 2014	957,644	47.72	950,643	214,574,272
September 1, 2014 through September 30, 2014	497,957	49.82	494,237	189,950,461
Total	1,850,688	$48.91	1,839,517	$189,950,461

(1) Includes shares of vesting restricted stock, and shares received on vesting of restricted stock units, surrendered to Legg Mason to satisfy related income tax withholding obligations of employees via net share transactions.

(2) Amounts exclude fees.

(3) In connection with a capital plan announced on May 16, 2012, our Board of Directors authorized $1 billion for additional purchases of common stock. The capital plan provides for using up to 65% of cash generated from future operations to purchase shares of our common stock. There is no expiration date attached to the share repurchase authorization in the capital plan.

Item 6. Exhibits

3.1	Articles of Incorporation of Legg Mason, as amended (incorporated by reference to Legg Mason's Current Report on Form 8-K for the event on July 26, 2011)
3.2	By-laws of Legg Mason, as amended and restated July 26, 2011 (incorporated by reference to Legg Mason's Current Report on Form 8-K for the event on July 26, 2011)
10.1	Legg Mason, Inc. Executive Incentive Compensation Plan, as amended (incorporated by reference to Appendix A to the definitive proxy statement for Legg Mason's 2014 Annual Meeting of Stockholders) *
10.2	Legg Mason, Inc. Deferred Compensation Fund Plan, as amended and restated effective September 1, 2014, filed herewith *
12	Computation of consolidated ratios of earnings to fixed charges
31.1	Certification of Chief Executive Officer
31.2	Certification of Principal Financial Officer
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	Financial statements from the quarterly report on Form 10-Q of Legg Mason, Inc. for the quarter ended September 30, 2014, filed on November 6, 2014, formatted in XBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income (Loss), (iv) the Consolidated Statements of Changes in Stockholders' Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to Consolidated Financial Statements tagged in detail

* This exhibit is a management contract or compensatory plan or arrangement

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LEGG MASON, INC.

DATE: November 6, 2014 /s/ Joseph A. Sullivan
Joseph A. Sullivan
President, Chief Executive Officer, and
Chairman of the Board

DATE: November 6, 2014 /s/ Peter H. Nachtwey
Peter H. Nachtwey
Senior Executive Vice President
and Chief Financial Officer

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