

# Long Island Transaction Overview

12<sup>th</sup> Sept 2008

Strictly Private and Confidential

## **Long Island is an excellent strategic fit that would dramatically advance our ambitions for IBIM**

---

- Impact on Group portfolio:
  - Reduced dependence on the UK from 55% to 45% of revenues, increased exposure to the US from 10% to 23% of revenues
  - IBIM contribution lifted as a % of whole to 52% - well within our long term goal
- Real strategic gain is achieving top 3 position in the world's largest capital market
- Long Island is a highly complementary fit for Baltimore's Investment Banking and Investment Management businesses – viewed across products, regional footprint and client franchise
  - Fills in i-banking product 'white spaces' with addition of top tier M&A and ECM franchises
  - Broadens client franchise in the US and Asia (e.g. Japan where Long Island has regional headquarters)
  - Strengthens Hedge Fund client base through addition of Long Island's Prime Brokerage and cash equity capabilities
- Investment management businesses offer either optionality or choice to accelerate the Wealth business into the US and move it towards the \$1bn PBT target
- This transaction would therefore achieve our global premier investment banking ambition
- Long Island franchise would benefit from operating under Baltimore's universal banking model
- There is a good cultural fit between the two companies:
  - Culture of both focuses on talent and execution
  - Integration therefore likely to be relatively straightforward

## Recent events have created a favourable deal environment and rare acquisition opportunity

---

- Long Island has become available at a distressed price due to
  - Significant holdings in illiquid, opaque real estate assets, which have undergone signified write downs
  - Rumour having undermined market confidence in Long Island management and business model
  - Regulatory pressure exists close out the situation quickly
- Long Island has announced a range of capital initiatives – none of which are finalised or included in this analysis. These may provide optionality to improve the combined businesses' capital position in future
- We expect to receive regulatory support in the US to complete this transaction
- At these pricing levels, we are able to review the business using conservative assumptions, take significant write downs on (already written down) assets and still achieve good economics
- We would consider two scenarios throughout this document

### Scenario 1 – “No synergies / no write downs”

- \$5 per share consideration (closing share price 11/9 at \$4.22)
- No synergies assumed
- Write downs limited to reversal of Own Credit gains, litigation provision and retention payments – total \$3.3bn pre-tax

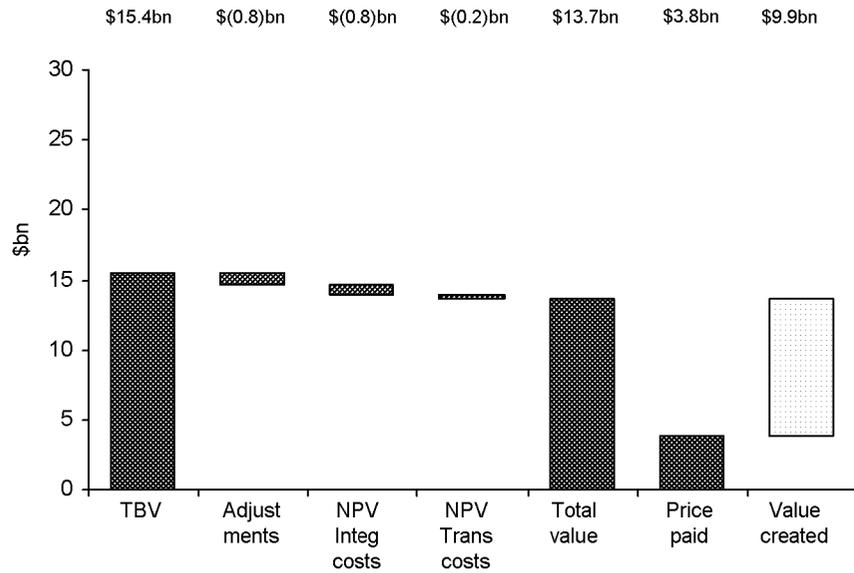
### Scenario 2 – “Synergies plus write downs”

- \$5 per share consideration
- Pre tax synergies of \$1.9bn p.a. and \$1.2bn one-off integration costs
- Write downs include additional impairment of Long Island assets of \$7.5bn (in addition to those included in Scenario 1) – total \$10.8bn pre-tax

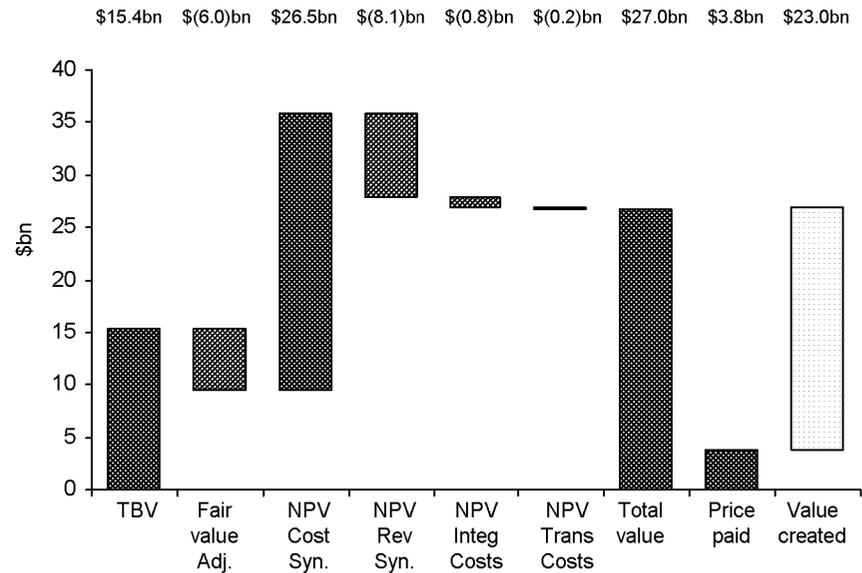
# Transaction creates significant value for Baltimore shareholders under either scenario

Scenario 1 – "No synergies / no write downs"

Scenario 2 – "Synergies plus write downs"



Value created: \$9.9bn

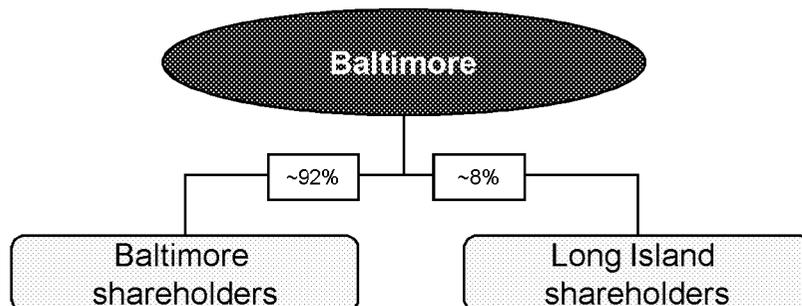


Value created: \$23.0bn

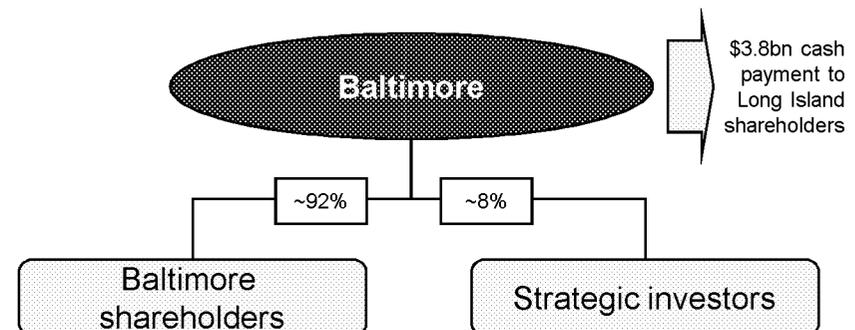
## Two simple all-share transaction structures are possible to acquire Long Island

- Baltimore would finance the transaction entirely in shares – whether issued directly to Long Island or to strategic investors. Under either structure the effect on Baltimore’s key metrics would be broadly similar
  - **Structure 1:** Issue Baltimore shares directly to current Long Island shareholders, most probably in the form of American Depositary Receipts
  - **Structure 2:** Issue shares to strategic investors in return for a cash injection, and pay cash to Long Island shareholders
- Baltimore Management would retain management control of the combined company
- Baltimore would remain headquartered and domiciled in the UK, we expect that the FSA would remain the lead regulatory authority [to be confirmed]
- We would anticipate seeking Baltimore shareholder approval irrespective of whether it is technically required

Structure 1: Post transaction structure



Structure 2: Post transaction structure



*Final shareholding of strategic investor to be determined*

## Neither scenario materially impacts Baltimore's starting capital ratio with absolute equity capital ratio being maintained above target

Scenario 1				
	Baltimore stand alone	Long Island stand alone	Adjustments	Combined
	\$bn	\$bn	\$bn	\$bn
Total Assets	2,187.9	641.7	-	2,829.7
RWAs	634.8	199.4	-	834.3
Tier 1 Capital	41.2	16.9	(0.2)	58.0
Tier 1 Ratio	6.49%	8.50%		6.95%
Leverage Ratio	1.66%	2.50%		2.05%

- Equity Tier 1 Ratio above Baltimore stand alone from Day 1
- Leverage Ratio improved over Baltimore stand alone

Scenario 2				
	Baltimore stand alone	Long Island stand alone	Adjustments	Combined
	\$bn	\$bn	\$bn	\$bn
Total Assets	2,187.9	641.7	-	2,829.7
RWAs	634.8	191.9	-	826.7
Tier 1 Capital	41.2	11.7	(0.2)	52.7
Tier 1 Ratio	6.49%	6.08%		6.38%
Leverage Ratio	1.66%	2.09%		1.86%

- Equity Tier 1 Ratio marginally below Baltimore stand alone on Day 1 (but above Capital Plan target), above stand-alone from 2009 onward
- Leverage Ratio improved over Baltimore stand alone

Further upside to capital ratios possible:

- Deleveraging (reducing RWAs), and streamlining the legal entity structure across the combined businesses
- Adopted the most conservative approach to accounting for Long Island's recently issued preference shares ('poison pill') – several further potential options (with upside to capital ratios to be quantified) exist to work around this issue
- Conservatively deducting integration related costs on acquisition though disbursements likely only to occur in 2009

Note: Adjustments include one-off deal costs

Page 6

**Combined financials are extremely attractive – transaction would be accretive from Day 1 and capital position would be enhanced**

**Scenario 1 – "No synergies / no write downs"**

\$bn	2008	2009	2010	2011
<b>Proforma</b>				
Net revenue	39.0	57.1	62.2	67.0
PBT	18.3	13.9	16.6	17.8
<b>Impact on Baltimore</b>				
Equity Tier 1 ratio	0.46%	0.53%	0.59%	0.64%
Leverage ratio	0.39%	0.22%	0.23%	0.23%
-----				
Reported EPS (post integration)		4.2%	14.1%	14.4%

\$bn	2008	2009	2010	2011
<b>Baltimore</b>				
Net revenue	40.8	43.3	46.4	49.6
PBT	10.8	11.5	12.2	12.9
Equity Tier 1 ratio	6.49%	6.22%	5.62%	5.16%
Leverage ratio	1.66%	1.72%	1.57%	1.46%
<b>Long Island</b>				
Net revenue	-	13.8	15.8	17.4
PBT	-	3.6	4.4	4.9
Equity Tier 1 ratio	8.50%	9.47%	9.31%	9.27%
Leverage ratio	2.50%	2.74%	2.98%	2.96%
<b>Other</b>				
Integration costs	-	(1.2)	-	-
Own credit reversal	(1.8)	-	-	-
Litigation costs	(0.5)	-	-	-
Retention payments	(1.0)	-	-	-
Reversal of negative goodwill	10.8	-	-	-

## Key issues and deal execution

---

### Potential risks

---

- Public/legal pressure to increase offer price following agreement (e.g. JPM Bear Stearns)
- Potential for competitor to emerge with higher offer following announcement
- Damage to US public/government relations if Baltimore steps aside
- Potential unmatched positions in Long Island book due to lack of willing counterparties as market rumours continue to impair Long Island
- A run on Long Island following takeover agreement – forcing Baltimore to provide additional funding
- Competitive situation emerges – implying Baltimore can only win via overpayment
- Negative UK sentiment towards investment banking at this time of the cycle impacting Baltimore stock
- Loss of key personnel at Long Island / Baltimore post deal

### Mitigants

---

- Offer price is in-line with current market and possible scope for public purse commitment
- Regulatory backing for the transaction – speed / certainty would be key from their perspective
- Clarity to Regulator that Board decision is subject to further due diligence
- Deal announcement, Baltimore's stable balance sheet and potentially regulatory support would increase certainty with counterparties
- Deal would be contingent on Fed support and agreed arrangements around interim liquidity
- Clear business strategy and value story, plus proven Baltimore willingness to 'walk away' from poor economics
- Strong strategic/economic rationale combined with simple transaction at attractive price
- Cultures compare favourably, plus Baltimore support removes business uncertainty for Long Island staff (in addition to potential retention scheme)

## **Key messages**

---

- Opportunity to capture a top 3 position in the world's principal capital market through the acquisition of a high quality business
- Immediate realisation of BarCap's global premier investment banking ambition
- Further progress towards geographic earnings diversification and increased exposure to the largest global pool of economic profit in the financial services industry
- The deal is attractive in terms of earnings enhancement and value creation and would be structured to ensure a material improvement in our equity ratio
- Synergies would provide significant extra value to Baltimore shareholders

## **Mandate and next steps**

---

- We seek Board consent to conduct due diligence leading to a potential offer and subject to the satisfaction of certain key pre-conditions, which include:
  - Strengthened equity ratio
  - Margin for error on write-downs
  - Put back ability on unwanted positions
  - Requisite US and UK regulatory clearances
  - Comfort on Project Spring
  - Access to c. \$5bn underwriting capacity in case of need
- The timing of the Long Island situation is such that we need to form a view during Friday as to whether we should recommend to the Board that we make an offer
- We are creating a standing Finance Committee of the Board to act as a Transaction Committee for this deal and we will have appropriate recourse to it and to the full Board over the course of the next 72 hours

## Appendix

---

0

## Other considerations to be resolved by DD

---

- Review of exposures to ensure sufficiency of write down allowances
- FSA need to agree to use Aggregation Plus regime for Long Island with an agreed transition period (this approach was followed in the Absa transaction)
- Solus capital considerations of the transaction
- Acceptance by regulator / ratings agencies that write downs are sufficient
- Funding structure for Long Island (Baltimore funding would consume significant RWAs)
- Accounting issues
  - Impact of conversion from US GAAP to IFRS of Long Island financials
  - Treatment of Long Island off-balance sheet vehicles, commitments and contingent liabilities
  - Understand valuations of level 2 and level 3 assets
- Litigation and legal exposures
- Exposures through special purpose entities (eg R3)
- Regulatory approval for iShares includes a provision that ETFs should not be related to any indices which are sponsored by Baltimore or an affiliate – may be solved through liaison with regulators or sale of the Index Provision business

## Background on Long Island Financials and trends in business

### Long Island: Historical Financials

	2005	2006	2007	Q1 07	Q2 07	Q3 07	Q4 07	Q1 08	Q2 08	Q3 08
(\$m)										
Income										
Investment Banking	12,701	15,166	16,160	4,352	4,744	3,506	3,558	2,539	(1,516)	(3,537)
Asset Management	1,026	1,432	1,887	416	460	468	543	618	496	360
Wealth Management	903	985	1,220	279	308	334	298	350	352	274
Net Income	14,630	17,583	19,267	5,047	5,512	4,308	4,399	3,507	(688)	(2,803)
<i>Growth</i>		20%	10%	11%	9%	(22%)	2%	(20%)	(119%)	NA
Compensation Costs	(7,213)	(8,869)	(9,494)	(2,483)	(2,713)	(2,124)	(2,164)	(1,341)	(2,325)	(1,260)
Non-Compensation Costs	(2,589)	(3,003)	(3,750)	(863)	(916)	(979)	(956)	(1,003)	(1,194)	(971)
Operating Expenses	(9,801)	(11,878)	(13,244)	(3,346)	(3,629)	(3,103)	(3,160)	(2,844)	(3,419)	(2,531)
<i>Growth</i>		19%	13%	10%	9%	(15%)	2%	(10%)	20%	(15%)
Profit Before Tax	4,829	5,905	6,023	1,699	1,879	1,205	1,239	663	(4,037)	(5,834)
<i>Growth</i>		22%	2%	14%	11%	(36%)	3%	(48%)	(718%)	NA
Profit After Tax	4,135	4,007	4,192	1,146	1,273	886	887	489	(2,774)	(3,827)
<i>Growth</i>		(3%)	5%	14%	11%	(30%)	0%	(45%)	(667%)	NA
Net MTM Adjustments (\$bn)							1.9	1.8	3.7	5.6
Return on Average Common Stockholders' Equity	21.6%	23.4%	20.8%	24%	26%	17%	17%	9%	(56%)	(94%)
Total Assets (\$bn)	410	504	691	562	606	659	691	786	639	600
<i>Growth</i>		23%	37%	12%	8%	9%	5%	14%	(19%)	(6%)
Net Assets (\$bn)	211	269	373	301	338	357	373	397	328	311
<i>Growth</i>		27%	39%	12%	12%	6%	4%	6%	(17%)	(5%)
Net Leverage Ratio	13.6x	14.5x	16.1x	15.4x	15.4x	16.1x	16.1x	15.4x	12.1x	10.6x
Tier 1 Ratio [US GAAP]									10.7%	11.0%

### Journey through Current Turmoil

- Held up well initially in the credit turmoil while the problems in the market were mainly in sub-prime
  - Achieved strong income and profit growth in '07
  - Maintained profit through Q1 '08
- Began facing difficulty as the sub-prime crisis spread to other asset classes e.g., leveraged finance and CMBS
- Markdowns / writedowns began in H2 '07 and increased significantly over the past 2 quarters -- total assets have fallen by \$186bn since Q1 '08
- In Q2 '08, Long Island had its first loss-making quarter since its IPO and faced liquidity concerns around the time of the Bear Stearns situation
- In July, faced another round of market confidence issues
- Has focused on decreasing assets, de-leveraging, and raising capital over recent months
- Discussion to sell strategic stake to KDB ended in early Sept. -- market has lost confidence in Long Island's ability to remain independent

## Long Island key exposures

	Long Island Net Exposure Q3 08		Balt. Net Exposure Q3 08 (for comparison)
	(\$bn)		(\$bn)
Commercial Mortgages	24.0	} High risk	20.6
Real Estate held for sale	8.6		0.0
ABS CDO Super Senior	0.5	} Medium risk	6.0
Alt-A	5.9		6.4
Other ABS	4.6		0.0
Monoline Insurers	0.3		6.7
Lev Fin	7.1		9.2
Other US sub-prime	1.6	} High risk	4.5
Other US/Europe/ Asia Res	9.2		0.0
High Grade	3.3		n.a.
SIVs and SIVs lite	0.0		0.7
<b>Total</b>	<b>65.1</b>		<b>33.5</b>
Other Assets	534.9		
<b>Total</b>	<b>600.0</b>		

- We have reviewed Long Island's key exposures and believe that the risk of these exposures varies considerably
- The level of uncertainty relating to these assets varies by the underlying's...
  - Visibility
  - Complexiity
  - Liquidity
- We believe the higher risk assets are the Commercial Mortgage and Real Estate exposures which are highly structured and need to be understood on an asset by asset basis
- Our due diligence process will focus on these assets and also review the wider book to ensure other exposures are correctly marked

**Potential write down allowance of \$7.5bn has been arrived at based on this high level risk analysis which will be validated in due diligence**

**Exposure and uncertainty**

	Long Island Net Exposure Q3 08	Valuation Uncertainty	
	(\$bn)	(\$bn)	%
Commercial Mortgages	24.0	(3.6)	15%
Real Estate held for sale	8.6	(1.3)	15%
ABS CDO Super Senior	0.5	(0.1)	10%
Alt-A	5.9	(0.6)	10%
Other ABS	4.6	(0.5)	10%
Monoline Insurers	0.3	(0.0)	10%
Lev Fin	7.1	(0.7)	10%
Other US sub-prime	1.6	(0.1)	5%
Other US/Europe/ Asia Res	9.2	(0.5)	5%
High Grade	3.3	(0.2)	5%
SIVs and SIVs lite	0.0	0.0	
<b>Total</b>	<b>65.1</b>	<b>(7.4)</b>	<b>-11%</b>
Other Assets	534.9		
<b>Total</b>	<b>600.0</b>		

**Long Island Q3 Marks**

Amount (\$m)	Long Island Q3 Marks	
<b>Residential Mortgages Marks</b>		
500	Asia	
1,600	Alt-A Servicing	
600	Alt-A AA I/O securities	
600	Reverse Mortgages	
3,700	Alt-A	39
1,600	Sub-Prime	34
3,600	Euro	69
500	ABS CDO	29
500	US	45
4,000	UK	
<u>17,200</u>		
<b>Commercial Mortgages and Real Estate Marks</b>		85
32,100		

## Marks analysis – Information provided on Long Island Q3 Earnings call regarding marking of real estate assets

---

Amount (\$m)	Description	Marks				Comments
		Q2	Q3	WD	Post WD on Acquisition	
<b>Residential Marks</b>						
500	Asia					
1,600	Alt-A Servicing					
600	Alt-A AA I/O securities					
600	Reverse Mortgages					39% LTV
3,700	Alt-A	63	39	10%	35.1	US Weighted average is 39, down from 59
1,600	Sub-Prime	55	34	5%	32.3	US Weighted average is 39, down from 59
3,600	Euro	83	69	5%	65.6	
500	ABS CDO	35	29	0%	29	
500	US	48	45	5%	42.8	
4,000	UK	???	???			
<u>17,200</u>						
<b>Commercial Marks</b>						
32,100		85	85	15%	72.3	Seniors are currently marked low 90s, Mezz in low 80s

## Scenario Definitions

---

### Scenario 1

- **Acquisition Price:** Long Island shares acquired at \$5 per share for a total consideration of \$3.8bn
- **Deal Financing:** 100% equity financed – either through share issue to Baltimore shareholders, or by share offer to L.I. shareholders
- **Additional write-downs:** None
- **Provisions taken for acquisition liabilities:**
  - Reversal of L.I. own Credit gains of \$1.8m (\$1.3bn 2008 AP impact)
  - Litigation of \$0.5bn (\$0.5bn 2008 AP impact– no tax benefit)
  - Retention payments of \$1bn (\$0.7bn 2008 AP impact)
- **Integration costs:** \$1.2bn (\$0.8bn AP impact), all taken in 2009
- **Synergies:** None

### Scenario 2

#### Same as Scenario one, with following additions:

- **Additional write-downs:** \$7.5bn (pre-tax) taken against TBV, reducing negative goodwill to be amortised (negative impact on AP going forward)
- **Synergies:** Net positive post-tax synergies of \$1.5bn, 50% achieved in 2009, 100% thereafter. Comprised of:
  - \$(2.3)bn of revenue attrition (estimate based on 50% of Baltimore's US business and 50% of its non-US equities business)
  - \$4.2bn of cost savings from headcount reduction in US and non-US equities businesses and removal of head office overlap

## The combined financials are extremely attractive

### Scenario 2 – "Synergies plus write downs"

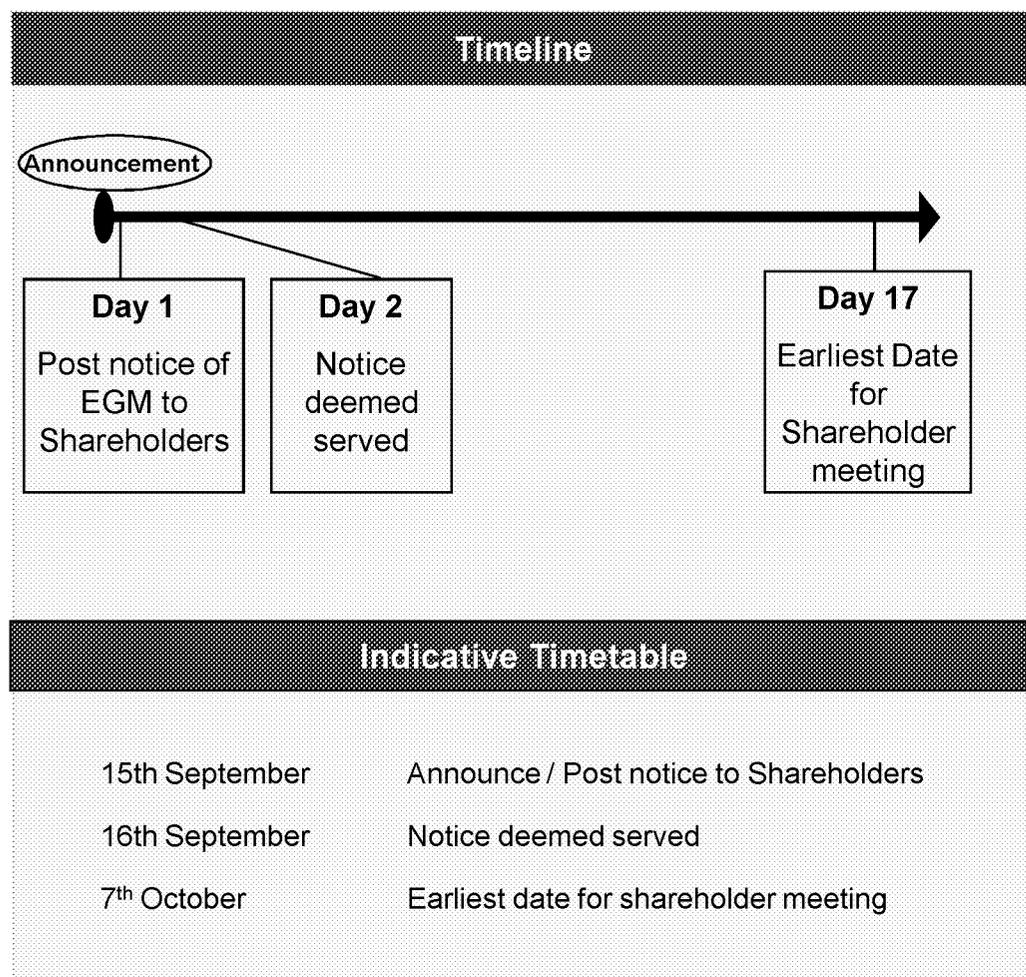
\$bn	2008	2009	2010	2011
<b>Proforma</b>				
Net revenue	39.0	56.0	59.9	64.7
PBT	13.0	14.8	18.5	19.7
<b>Impact on Baltimore</b>				
Equity Tier 1 ratio impact	(0.12%)	0.11%	0.47%	0.67%
Leverage ratio impact	0.20%	0.07%	0.13%	0.18%
Reported EPS impact (post integration)		14.3%	33.4%	32.2%
<b>Baltimore</b>				
Net revenue	40.8	43.3	46.4	49.6
PBT	10.8	11.5	12.2	12.9
Equity Tier 1 ratio	6.49%	6.22%	5.62%	5.16%
Leverage ratio	1.66%	1.72%	1.57%	1.46%
<b>Long Island</b>				
Net revenue	-	13.8	15.8	17.4
PBT	-	3.6	4.4	4.9
Equity Tier 1 ratio	6.08%	6.53%	6.63%	6.81%
Leverage ratio	2.09%	2.03%	2.22%	2.37%
<b>Other</b>				
Integration costs	-	(1.2)	-	-
Own credit reversal	(1.8)	-	-	-
Litigation costs	(0.5)	-	-	-
Retention payments	(1.0)	-	-	-
Reversal of negative goodwill	5.5	-	-	-
Revenue synergies	-	(1.1)	(2.3)	(2.3)
Cost synergies	-	2.0	4.2	4.2

## The combined financials are extremely attractive

### Scenario 2 – "Synergies plus write downs"

\$bn	2008	2009	2010	2011
<b>Baltimore</b>				
Net revenue	40.8	43.3	46.4	49.6
PBT	10.8	11.5	12.2	12.9
Equity Tier 1 ratio	6.49%	6.22%	5.62%	5.16%
Leverage ratio	1.66%	1.72%	1.57%	1.46%
<b>Long Island</b>				
Net revenue	1.2	13.8	15.8	17.4
PBT	(10.9)	3.6	4.4	4.9
Equity Tier 1 ratio	6.08%	6.53%	6.63%	6.81%
Leverage ratio	2.09%	2.03%	2.22%	2.37%
<b>Other</b>				
Integration costs	-	(1.2)	-	-
Own credit reversal	(1.8)	-	-	-
Litigation costs	(0.5)	-	-	-
Retention payments	(1.0)	-	-	-
Revenue synergies	-	(1.1)	(2.3)	(2.3)
Cost synergies	-	2.0	4.2	4.2
Amort'n of g'will (w/ downs)	5.3	-	-	-

## Shareholder Approval Critical Path



Comments
<ul style="list-style-type: none"> <li>▪ For Long Island a merger agreement is most likely scenario, requiring shareholder approval</li> <li>▪ Since October 2007, there is no requirement for 21 days notice in the UK when a special resolution is proposed.</li> <li>▪ 14 days clear notice required under Barclays PLC articles of association</li> <li>▪ Long Island timeline is dependant on its company charter, Delaware law and NYSE rules. Initial no-names view from S&amp;C is that stockholder approval would take c.1month</li> <li>▪ Given regulatory consent requirements, stockholder approval unlikely to delay any potential transaction             <ul style="list-style-type: none"> <li>– JPM / Bear Stearns had received all required regulatory approvals at announcement</li> </ul> </li> </ul>