

From: Foskett, Christopher M [CMB-GBKG] [cf09147@imcnam.ssmb.com]
Sent: Tuesday, September 09, 2008 1:11 PM
To: Fontana, Thomas [CMB-RISK]; Leach, Brian [CCC]; Evans, Richard CS [CMB-RISK]; Schwartz, Thomas [GWM-RISK]; Obermaier, Thomas [CMB-GTS]; Kirchen, Karen [CMB-GCO]; Ryan, Patrick [CMB-RISK]
Cc: Torres, Melissa J [CMB-RISK]; Mauerstein, Michael [CMB-GBKG]
Subject: Re: Lehman Third Quarter Update - Confidential

Sensitivity: Confidential

The client has said they see no problem in providing a guarantee the obligations of the US broker dealer. We have sent them an amendment to our existing guarantee reflecting such.

Sent from my BlackBerry Wireless Handheld

----- Original Message -----

From: Fontana, Thomas [CMB-RISK]
To: Leach, Brian [CCC]; Evans, Richard CS [CMB-RISK]; Schwartz, Thomas [GWM-RISK]; Obermaier, Thomas [CMB-GTS]; Kirchen, Karen [CMB-GCO]; Ryan, Patrick [CMB-RISK]
Cc: Foskett, Christopher M [CMB-GBKG]; Torres, Melissa J [CMB-RISK]; Mauerstein, Michael [CMB-GBKG]
Sent: Tue Sep 09 12:52:56 2008
Subject: RE: Lehman Third Quarter Update - Confidential

We are pulling together all of our exposure. We have reduced our clearing lines significantly, some to zero. In the US, we are short nearly \$2B. We are looking to improve our claim on the \$2B deposit today.

Best regards,

Tom

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-----Original Message-----

From: Leach, Brian [CCC]
Sent: Tuesday, September 09, 2008 12:50 PM
To: Fontana, Thomas [CMB-RISK]; Evans, Richard CS [CMB-RISK]; Schwartz, Thomas [GWM-RISK]; Obermaier, Thomas [CMB-GTS]; Kirchen, Karen [CMB-GCO]; Ryan, Patrick [CMB-RISK]
Cc: Foskett, Christopher M [CMB-GBKG]; Torres, Melissa J [CMB-RISK]; Mauerstein, Michael [CMB-GBKG]
Subject: Re: Lehman Third Quarter Update - Confidential
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So what is our current total exposure? What are we doing about settlement and clearing lines?

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From: Fontana, Thomas [CMB-RISK]
To: Leach, Brian [CCC]; Evans, Richard CS [CMB-RISK]; Schwartz, Thomas [GWM-RISK]; Obermaier, Thomas [CMB-GTS]; Kirchen, Karen [CMB-GCO]; Ryan, Patrick [CMB-RISK]
Cc: Foskett, Christopher M [CMB-GBKG]; Torres, Melissa J [CMB-RISK]; Mauerstein, Michael [CMB-GBKG]
Sent: Mon Sep 08 21:58:48 2008
Subject: Lehman Third Quarter Update - Confidential

Today Chris Foskett, Michael Mauerstein and I met with Lehman's Global Treasurer. We had been invited to hear an

update on their Third Quarter Results and Game Plan going forward.

Lehman's management has become convinced that it is in the best interest of the firm and its external constituencies to accelerate its efforts to cleanse their balance sheet and create a "Core" Lehman. This will result in the spinning off most of their Commercial Real Estate portfolio to existing shareholders \$28B of their \$33.2B CRE (Lehman will initially provide 75% of the financing and hope to syndicate at a future date), reduce residential exposure by approximately 50% to \$11.8B, reduce HY acquisition financing from \$11.5B to \$7.5B (down 38%) and raise incremental equity through the sale of roughly 51% of part of their investment management business and raise \$4.5B from a strategic investor (A Korean consortium was willing to invest \$6B, but recent turmoil in Korea makes this transaction unlikely). Many moving pieces with the hopes of announcing all of the pieces next week. The firm is continuing ongoing dialogue with various strategic investors, including SWFs, PE and a large commercial bank. The equity raise and/or a sale of part of the IMB is essential to maintain equity at "Core" Lehman and appropriately capitalize the new CRE Company.

After this cleansing, Lehman believes it will have one of the cleanest balance sheets amongst its peer group, possibly the world. The write downs will be sizeable, \$7.5B pre-tax, a loss of almost \$6 per share and net loss of \$3.9B. This follows pre-tax losses in each of the last four quarters as follows: 3/07 - \$3.5B, 4/07 - \$3.2B, 1/08 - \$5.3B, and 2/08 - \$3.9B, roughly \$23.4B in aggregate, nearly the equivalent of the firms total equity. Lehman expects to have equity of \$30 billion in Core Lehman which will be our ongoing client and counterparty.

Core revenues will be down, but still above break even. HC liquidity is down slightly, from \$45B to \$42B. For Core Lehman, target capitalization is as follows:

Net leverage 12-13Xs
Tier 1 Capital > 10%

The company will also be reducing its common dividend slightly and reducing headcount by 1,000. Lehman is confident it can generate \$13.3B of revenues in 2009.

Lehman is still experiencing market share gains in all areas of origination and trading, essentially maintaining revenues as 2007 levels, although market conditions remain a concern.

Lehman has written down its overall residential mortgage portfolio to a level whereby for a 0% yield 80-100% of the remaining borrowers could default assuming a 35% recovery rate. For its Prime and Alt-A and AAA Loans, Lehman could have 100% defaults and generate a 0% yield.

Of further interest, hedges continue to perform poorly relative to the Alt-A residential risk.

The meeting was generally very upbeat as the firm truly believes this recapitalization, write down and restructuring will clearly put behind their legacy issues and enable them to focus on "Core" Lehman and get the firm moving forward once more. None of our other major broker clients has been as open as Lehman in providing this degree of insight into their reserve levels and advance view of their quarterly earnings, perhaps this speaks to the significance of Citigroup to the firm. While we believe the plan is a net positive, we also recognize they do not have the pieces fully in place at this time, and like the Korean negotiations, a number of the pieces could still fall through. They are extremely hopeful that the market, once they digest the magnitude of the plan, will get beyond the \$6 per share loss and react positively. They also believe that should their stock fall into the single digits that a buyer will emerge.

Best regards,

Tom Fontana and Michael Mauerstein