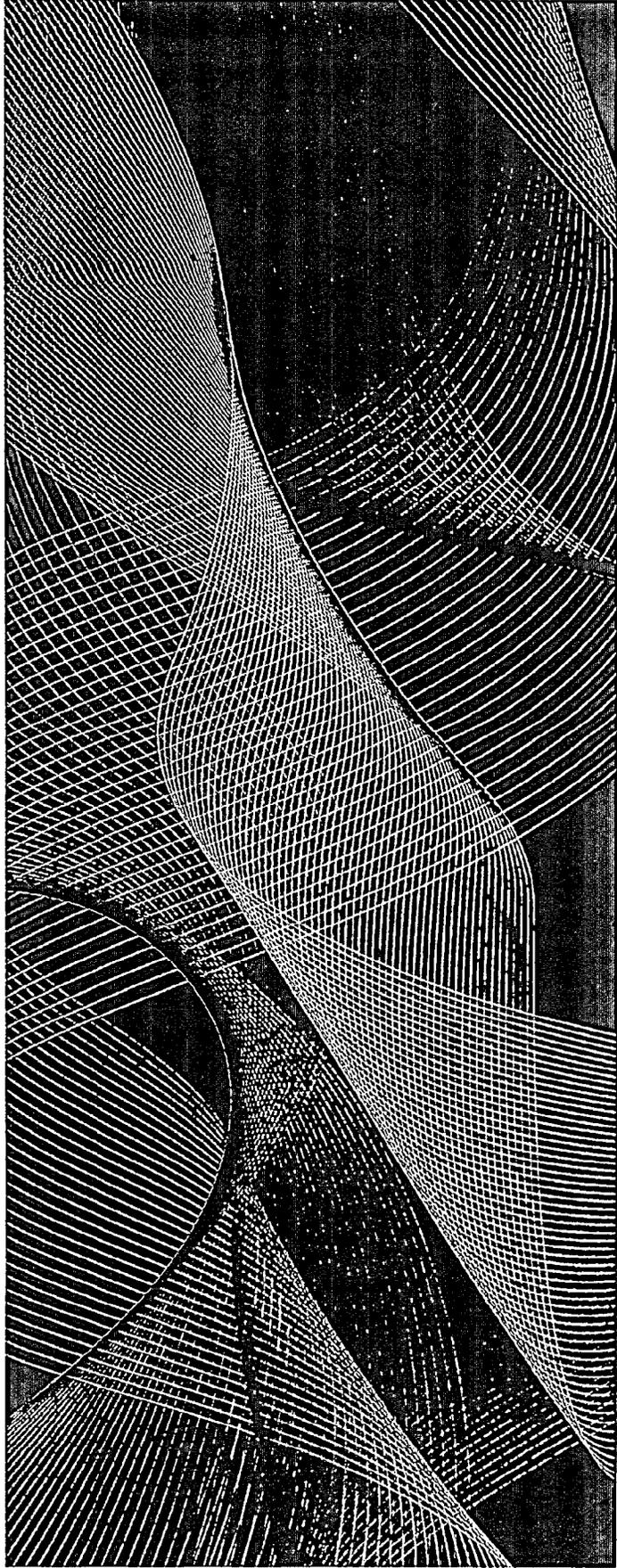


LEHMAN BROTHERS

June 4, 2008

# Q2 2008 Update



Confidential Presentation

# Cautionary Notes

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# Overview

Despite a sizeable forecast loss of roughly \$2.6 billion, the actions taken by Lehman in Q2'08 will result in the strongest capital and liquidity positions the Firm has ever had

◆ The issuance of \$4.0 billion of convertible preferred in April and \$2.0 billion of subordinated debt in May, combined with the active de-leveraging and de-risking of the balance sheet (approximately \$140 billion reduction in gross and almost \$70 billion reduction in net assets), combine to drive very strong forecasted capital ratios

- Net leverage of 12.1x, down from 15.4x in Q1 '08
- CSE Capital Ratio of 16.7%, up from 15.5% in Q1 '08
- Tier 1 Capital Ratio of 11.1%, up from 10.3% in Q1 '08
- Surplus over Lehman's internal equity allocation model of 16.3% (\$4.4bn) in Q2 '08

*10x with new capital*

*at distressed bids on  
 ↳ Q2 loss: <sup>Residual</sup> <sub>map</sub>  
 applied prices to the  
 rest of the book  
 \* great performance of  
 fixed income.  
 \* focus now on doing  
 biz, not on selling  
 assets*

*cash*

◆ Liquidity Pool stood at a record \$45 billion (up from \$34 billion in Q1 '08)

- Increased coverage of short-term debt up of 1.3x, up from 1.0x in Q1 '08
- Cash Capital Surplus estimated to be at \$14 billion

◆ Lehman is actively exploring replenishing the common equity lost in Q2 '08 with strategic investors, both in the US and internationally

- While capital ratios are very strong, we appreciate that Q2 '08 results will be a disappointment to the market
- Co-announcing a capital raise with earnings would likely reassure the market and improve Lehman's competitive position

*target: maintain as much term repo as possible, in excess of assets per asset class. Remove in assets to  
 provide both with flexibility to give counterparties  
 the assets they want. Cost is negative carry.  
 Counterparties with fear have already responded.*

# Overview

The loss for the quarter, while large, is less concerning when deconstructed into its constituent pieces as it illustrates that “one-time” factors explain most of the poor performance and that Lehman’s underlying franchise remains strong and competitive

- ◆ Underperformance is concentrated in Fixed Income, while the other parts of Lehman – Equities, Investment Banking and Investment Management – are performing well
- ◆ The Revenue Run Rate for the quarter is \$4.5 billion, down 5% from Q1 ‘08. However:
  - While gross writedowns are lower in Q2 ‘08 than Q1 ‘08 – \$4.1 billion vs. \$5.5 billion – hedges which generated \$3.4 billion of offset in Q1 ‘08 generated minor gains in Q2, resulting in a \$1.8 billion quarter-to-quarter increase in net writedowns
  - Additionally, in Q2 ‘08 Lehman lost money on two defensive trading positions (Credit Basis and Long Interest Rates) which together reduced revenues by \$776 million
    - These positions were prudent in a post-Bear world
    - Customers generally wanted to be long credit in April, so reducing the credit position was in part the result of supporting Lehman’s customer franchise
    - Positions had generated \$668 million of revenues in Q1 ‘08, resulting in a quarter-over-quarter swing of \$1.4 billion
  - Principal investing in Q2 ‘08 lost \$408 million vs. a gain of \$156 million in Q1 ‘08, a \$564 million quarter-over-quarter differential

<i>\$ billions</i>	<i>Actual</i>	<i>Forecast</i>	<i>QoQ</i>
	<i>Q1'08</i>	<i>Q2'08</i>	<i>Δ</i>
Run Rate	4.8	4.5	(0.2)
Gross Writedowns	(5.5)	(4.1)	1.4
Hedges	3.4	0.3	(3.1)
Net Writedowns	(2.1)	(3.8)	(1.8)
Defensive Trading	0.7	(0.8)	(1.4)
Principal	0.2	(0.4)	(0.6)
Net Revenues	3.5	(0.5)	(4.0)

*\$5B capital raise with few investors*

*← risk-reducing trades*

*GLG - 2 year position  
- portions in hedge funds  
- private equity seed money*

# Overview

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- ◆ We believe that Lehman's core underlying franchise remains as strong as ever
  - Gaining market share in Investment Banking
  - Sales credits in Fixed Income remain strong; only down 3% in Q2 '08 vs. Q1 '08
  - Investment Management Division is performing well
  - Hedge ineffectiveness is technical in nature and is not expected to drive future results
  - Defensive trading positions prudent in post-Bear environment
  - De-leveraging in Q2 '08 is a contributing factor in explaining results, but de-risking is appropriate
  
- ◆ Impact of S&P long-term rating downgrade from 'A+' to 'A' is limited and does not adequately reflect Lehman's strong liquidity and capital positions, balance sheet improvement and underlying franchise strength
  - Lehman's funding ability is unaffected by the downgrade
  - No triggers in borrowing agreements that would cause Lehman to lose cash
  - Impact on collateralization is minimal, with an extra \$200 million in additional required collateral to support derivatives trades

→ March was bad month  
May was strong month

# Capital Adequacy

# \$6 billion of Capital Raised in Q2 and \$7.9 billion in 2008...

Lehman's ability to raise substantial amounts of capital in 2008 conveys a positive story about the Firm's access to funding as well as the market's view of Lehman's creditworthiness

## \$4.0 B Convertible Preferred Stock

- ◆ Issued in April 2008
- ◆ Non-Cumulative Dividends at 7.25%, Perpetual  
Initial Conversion Rate 20.0509 per share, equivalent to \$49.87 strike per share
- ◆ Deeply Subordinated and senior only to Common Equity
- ◆ Included as CSE Equivalent Tier 1 Capital
- ◆ **More than three times oversubscribed**

## \$2.0 B Subordinated Debt

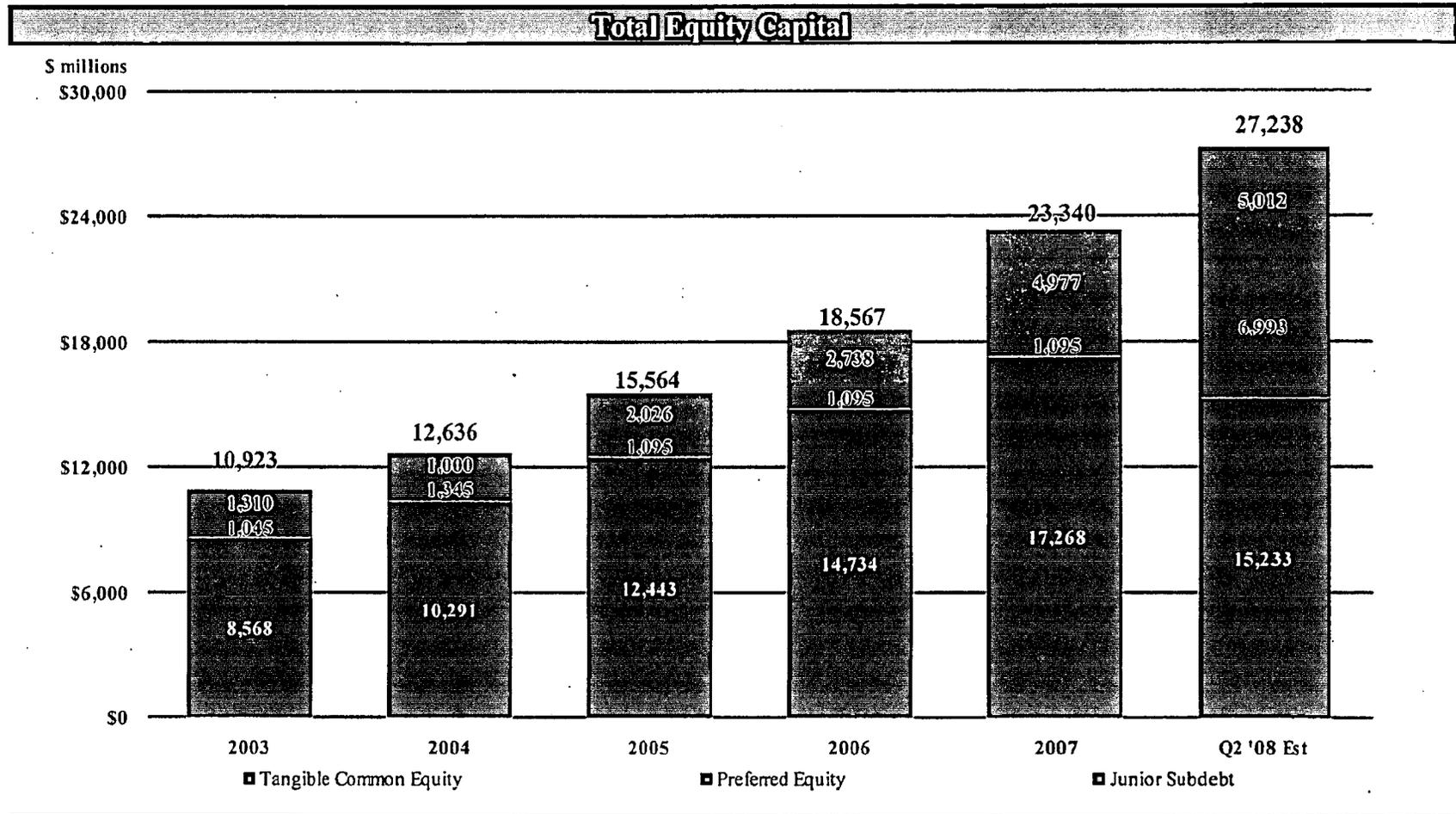
- ◆ Issued in May 2008
- ◆ Coupon of 7.50%, 30-year maturity
- ◆ Subordinate to Senior Debt
- ◆ Included as CSE Equivalent Tier 2 Capital
- ◆ **\$4.0 billion of orders within one hour**

## \$1.9 B Preferred Stock

- ◆ Issued in February 2008
- ◆ Non-Cumulative Dividends at 7.95%, Perpetual
- ◆ Includes Greenshoe of ~\$250 million
- ◆ Deeply Subordinated and senior only to Common Equity
- ◆ Included as CSE Equivalent Tier 1 Capital

# ...Has Resulted In a Solid Capital Base...

Lehman was quick to respond to market demand by raising equity capital via hybrid issuances when markets were opportune



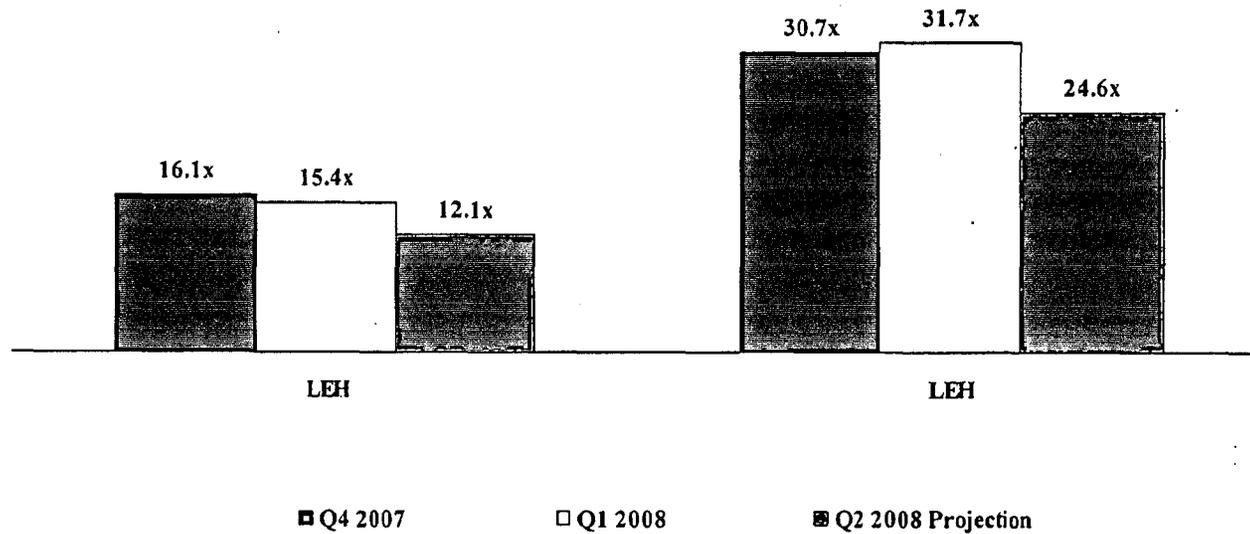
# ...As Well As Shrinkage of the Balance Sheet...

Net balance sheet (primarily inventory) is expected to be almost \$70 billion lower than Q1 '08, and gross balance sheet is expected to be almost \$140 billion lower

## Gross and Net Balance Sheet

<i>\$ billions</i>	<i>Actual</i> <u>Q4' 07</u>	<i>Actual</i> <u>Q1' 08</u>	<i>Estimated</i> <u>Q2 ' 08</u>	<i>Estimated Reduction</i> <u>Q2 '08 vs. Q1 '08</u>
Net Assets	373	397	330	(67)
Gross Assets	691	786	648	(138)
Leveragable Equity	23	26	27	

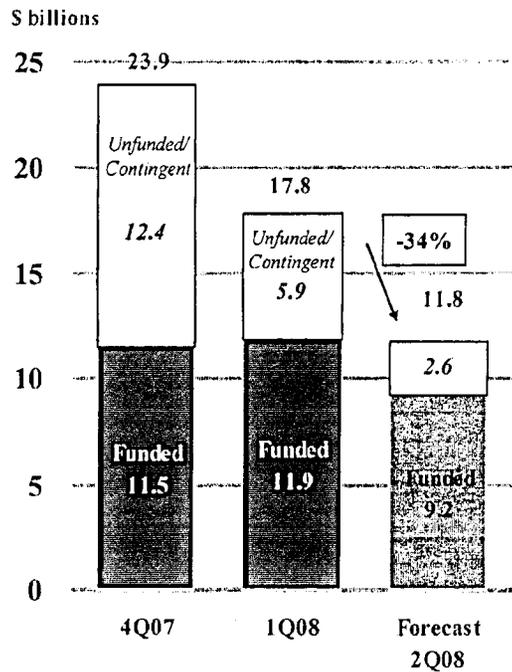
## Gross and Net Leverage Ratios



# ...Including Positions in High-Risk Assets

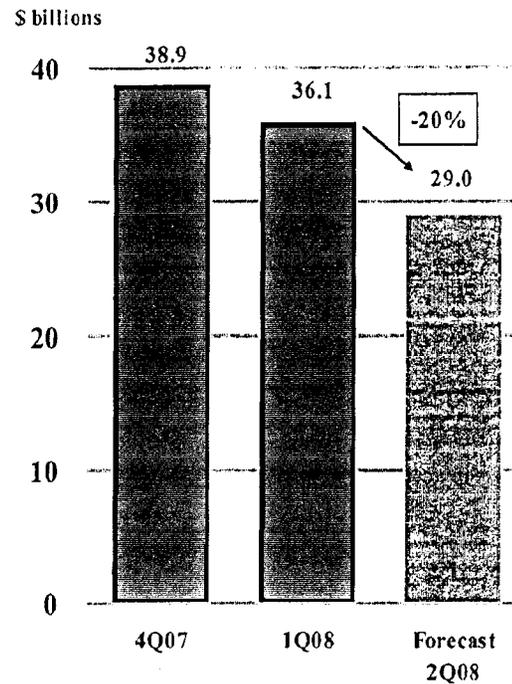
Lehman Brothers is on track to reduce the Firm's key Risk positions in the Fixed Income arena

## High Yield Acq Financing



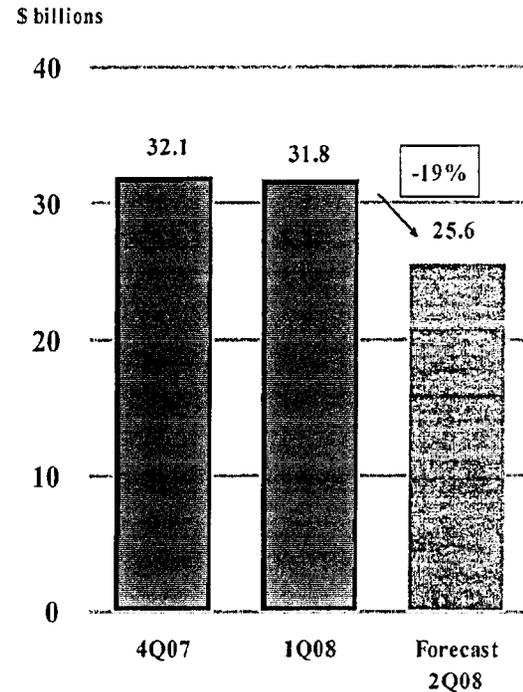
- ◆ Steady progress in selling/syndicating
- ◆ Non-traditional buyers account for 73% of sales in 2008

## Commercial Mortgages



- ◆ Sales have been focused on largest exposures

## Residential Mortgages



- ◆ Includes whole loans & securities in ~ 40: 60 proportion

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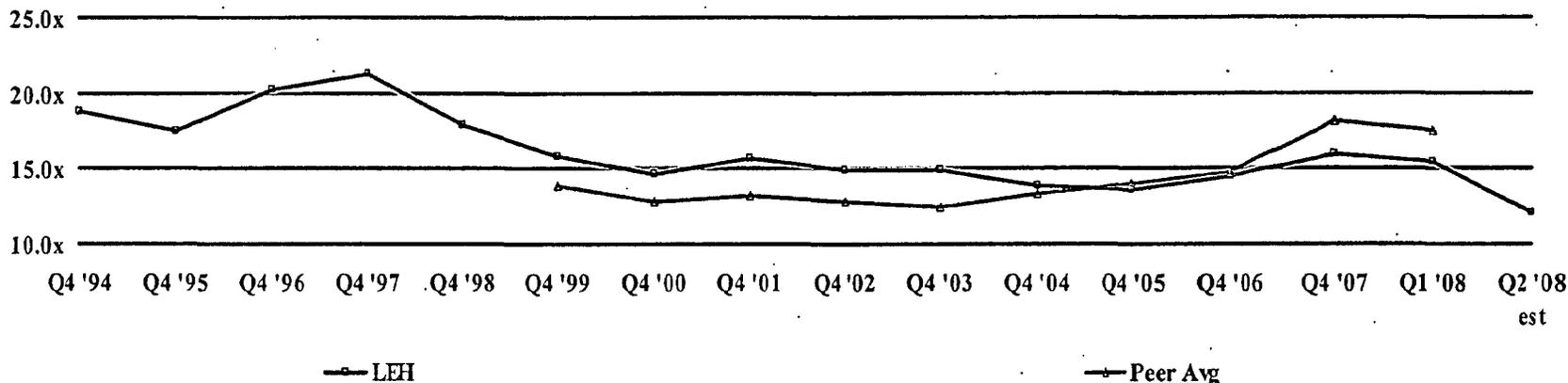
TXU  
IHR  
Hilton  
BBK

- MTM using reference prices from sales  
 - Sub Prime < \$3B    AltA \$7B mostly AAA & AA securities  
 8 - No big positions.

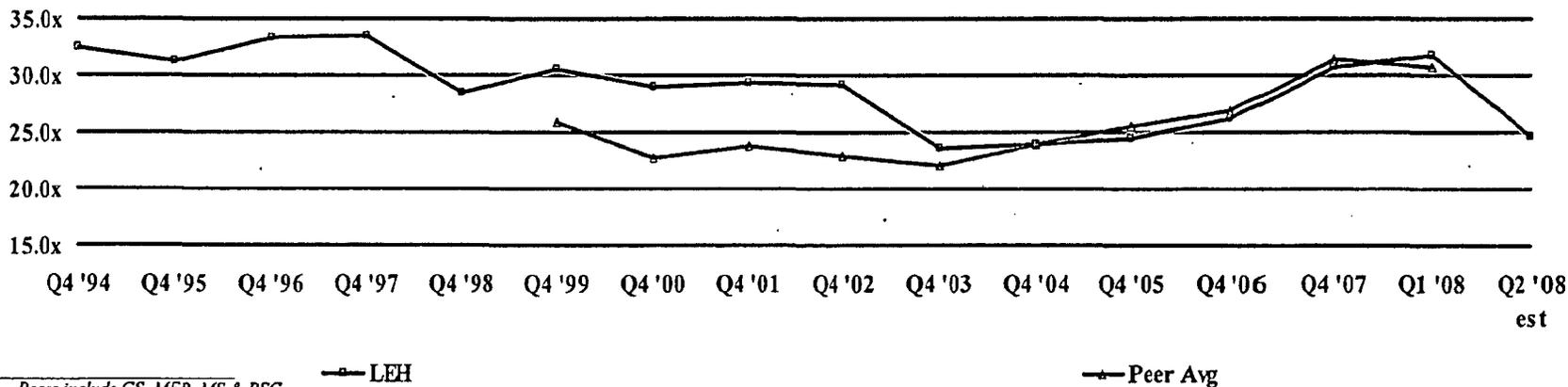
# Leverage At Historically Low Levels

Lehman will end Q2 '08 with the lowest net leverage ratio in its history as a public company

**Lehman versus Peers Net Leverage<sup>1</sup>**



**Lehman versus Peers Gross Leverage<sup>1</sup>**



<sup>1</sup> Peers include GS, MER, MS & BSC.

# Despite Anticipated Loss, Lehman Is Strongly Capitalized

As a result of the combined impact of Lehman's capital raising and deleveraging, Lehman is currently well-capitalized by three key measures

- ◆ To monitor equity adequacy the Firm uses three measures: Net Leverage, CSE Capital Ratios and our internal Equity Adequacy Framework (EAF)

## Net Leverage

- ◆ Accounting ratio that measures the value of assets supported by \$1 of equity
- ◆ Does not account for different risk/liquidity characteristics of assets
- ◆ Heavily quoted by journalists and analysts

Q2 '08  
Estimate

Net Leverage = 12.1x

## CSE Capital Ratios

- ◆ Measures by which regulators determine whether a bank is adequately capitalized
  - Tier 1 and Total Capital Ratio
- ◆ Account for on- and off-balance sheet assets with different risk profiles
- ◆ Will begin reporting externally in Q2 '08

Tier 1 Ratio = 11.1%<sup>1</sup>  
Total Capital Ratio = 16.7%

## Equity Adequacy Framework

- ◆ Multi-factor model that determines the Gross Equity (Common Equity + Hybrid Equity) requirement
  - Additive charges for Trading, Counterparty, Operational, Liquidity, and Corp Assets
- ◆ Accounts for on and off-balance sheet assets with different risk profiles
- ◆ Liquidity component will be charged to businesses

Surplus = \$4.4 billion  
(16.3% of gross equity required)

1. Updated for approved SEC Methodology. If FV gains on debt are excluded from capital then Q2 '08 ratios would be 10.5% Tier 1 and 15.8% Total Capital

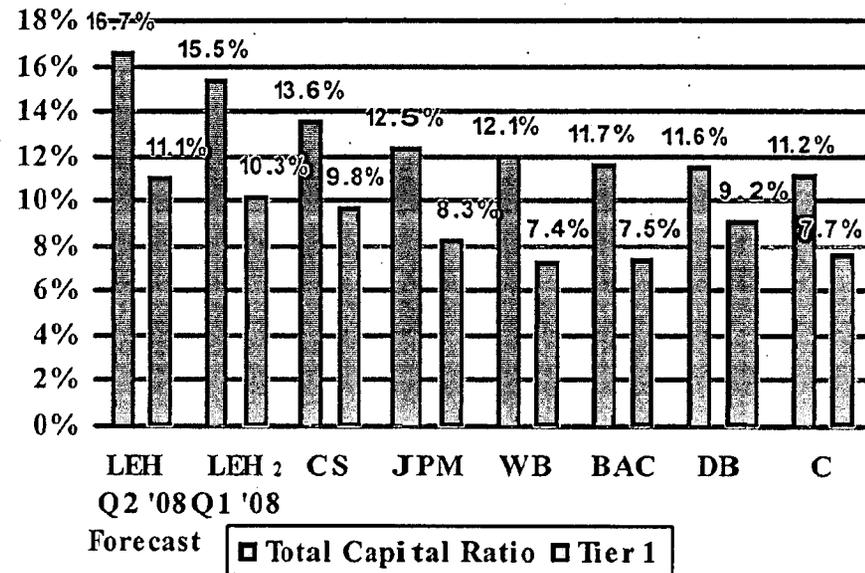
# CSE Capital Ratios Strong

The Firm has made a conscious decision to shore up its capital base and maintain a Total Capital ratio under the CSE regime above that of the major Commercial Banks' equivalent Total Capital Ratio under Basel

## Consolidated Supervised Entity (CSE)

- ◆ The Firm must maintain a minimum "Total Risk-Based Capital Ratio", as defined as allowable capital divided by risk weighted assets, of **10.0%**
- ◆ Allowable capital consists of common equity, perpetual preferred stock, and hybrids/ subordinated debt subject to certain thresholds and restrictions less deductions (e.g. Goodwill, DTA, and other)
- ◆ Risk-weighted assets are principally driven by market risk, credit risk and operational risk allowances computed using methodologies developed by the Company and approved by the SEC.

## Total Capital and Tier 1 Ratios<sup>1</sup>



1. All Banks' ratios are as of Q1 '08 per their Earnings press releases  
 2. Updated for approved SEC Methodology. If FV gains on debt are excluded from capital then Q2'08 ratios would be 10.5% Tier 1 and 15.8% Total Capital

# EAF Highlights Lehman's Strong Capital Position

Lehman's Equity Adequacy Framework (EAF) calculates the equity required to enable restructuring during a crisis without accessing capital markets and haircutting existing senior debt holders

- ◆ The Firm is expected to close Q2 '08 with an equity surplus of \$4.4 billion, or 16.3% more than the total gross equity required by the EAF model

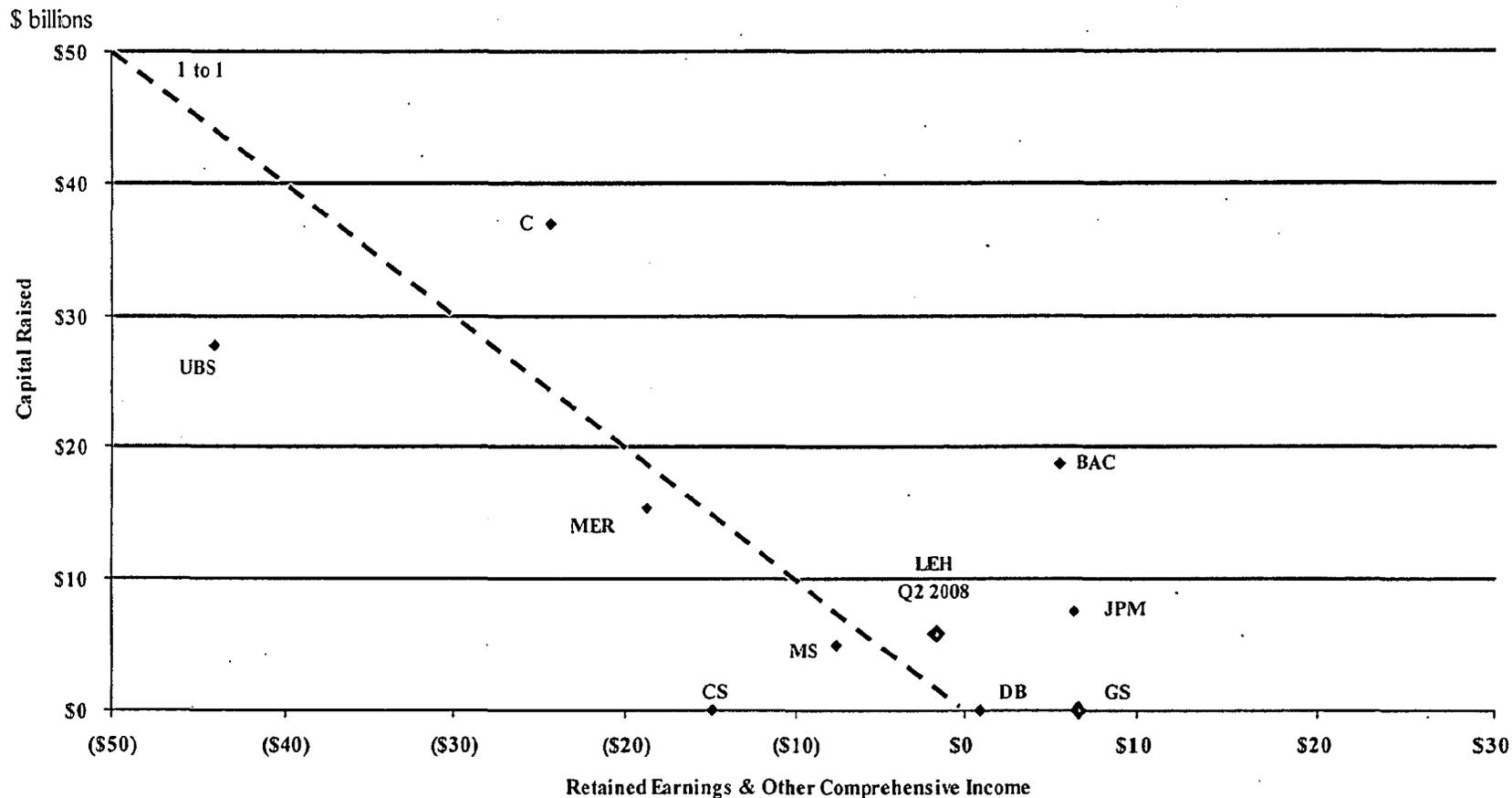
<b>Equity Adequacy Framework Surplus/(Deficit) Q2 '08 Forecast</b>			
<u>Performance Data</u>		<u>Equity Required</u>	
<i>in \$ millions</i>	<u>Q2' 08</u>	<i>in \$ millions</i>	<u>Q2' 08</u>
VaR 95% 1 day	105	Trading	3,453
Counterparty Risk Appetite	456	Counterparty	958
Less Liquid Assets		Less Liquid Funding Haircuts	
<i>Less Liquid Inventory</i> <sup>1</sup>	154,494	<i>Less Liquid assets</i>	15,637
<i>Fixed Assets</i>	3,861	<i>Fixed assets</i>	2,902
<i>Goodwill</i>	4,127	<i>Goodwill</i>	1,227
<i>DTA</i>	2,309	<i>DTA</i>	1,847
Total	164,791	Total	21,613
Revenue (FY 2007)	19,257	Operational	963
		<b>Total Gross Equity Required</b>	<b>26,986</b>
		<u>Gross Equity Available</u>	
		Common Equity	19,407
		Hybrids/Preferred	11,969
		<b>Total Gross Equity</b>	<b>31,376</b>
		<b>Surplus/(Deficit)</b>	<b>4,390</b>

1. *Less Liquid Assets includes commitments*

# Capital Raising More than Enough to Offset Lower Earnings

The Firm has proactively raised capital when markets were opportune and has adequate capital to cover depressed earnings during the current downturn

**Capital Raised<sup>1</sup> versus Retained Earnings and Other Comprehensive Income Q3 '07 to Q1 '08**



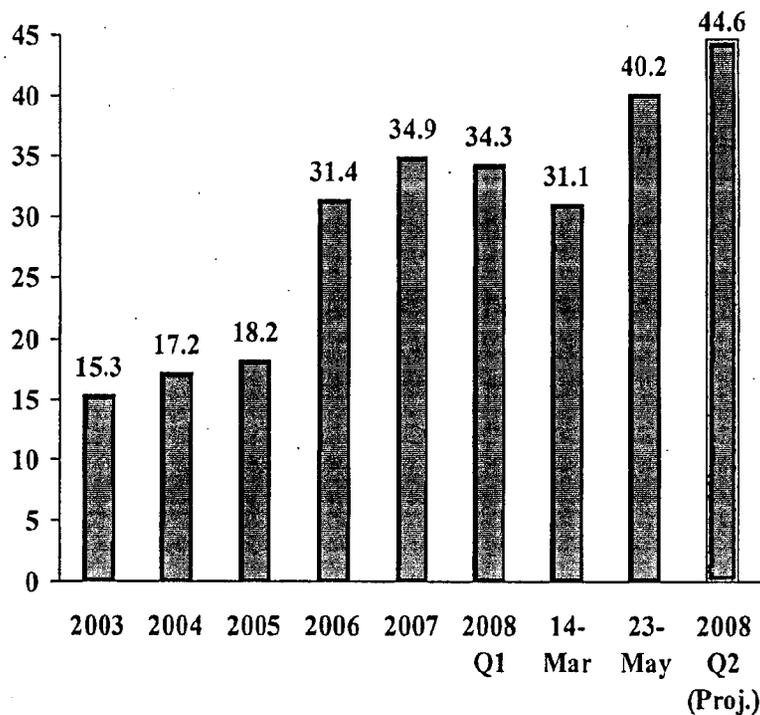
1. Includes equity raised through 5/30/08

# Liquidity

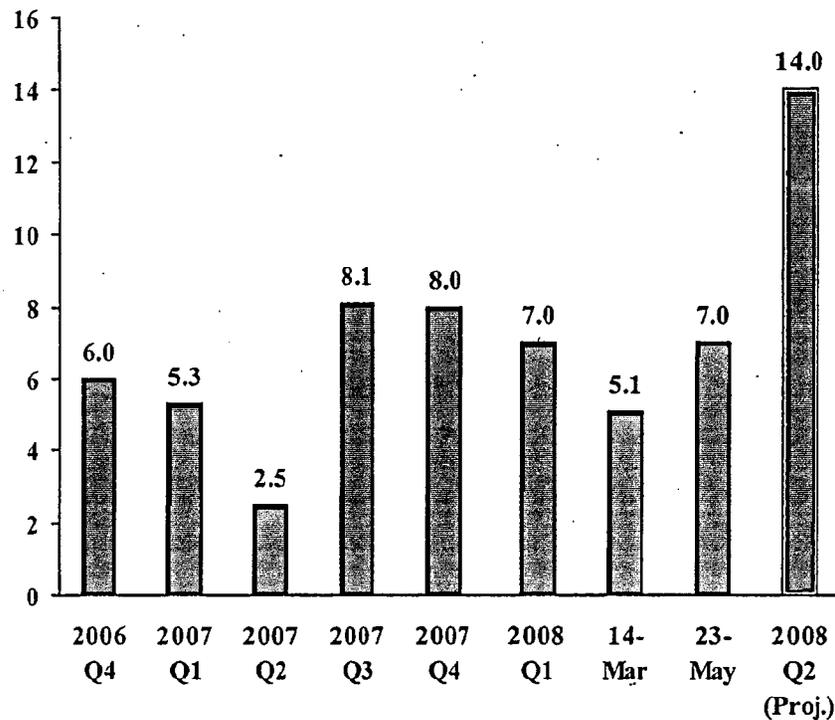
# Building A "Liquidity Fortress"

- ◆ We project ending the quarter with a record liquidity pool of approximately \$45 billion and a record cash capital surplus of \$14 billion
- ◆ With only \$8 billion of debt moving into current portion for the remainder of the year and with further cash inflows forecast from assets sales, there is minimal refinancing pressure

**Liquidity Pool (\$billions)**



**Cash Capital Surplus (\$billions)**



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*13B full credit 14*

*excludes \$20B liquidity at B/D's & Banks*

# Reducing Liquidity Risk Of Secured Funding

- ◆ We have increased our overfunding from around \$10-15 billion to \$15-20 billion – more than half in non-Central Bank eligible collateral – primarily high yield corporates
  - Including excess collateral (i.e., collateral reversed to fill repo tickets), the excess repo capacity stood at close to \$30 billion on May 22 – 30% of the Firm and customer collateral funded that day
- ◆ We also increased the average tenor of the repo book from 20-25 days to 25-35 days (35-40 days for collateral that cannot be pledged to the Federal Reserve or the ECB)
- ◆ We are seeing increasing appetite for providing term funding and have raised \$5 billion of additional term financing in the past few weeks

<b>Non-Traditional Repo Book Metrics</b>						
	29-Feb	4-Mar	14-Mar	2-Apr	22-May	3/14 - 5/22 Change
<b>Repo Book (\$ Billions)</b>						
Excess collateral		Not available			12.8	
Firm and customer collateral					98.9	
Allocated Collateral	116.4	114.0	115.3	108.3	111.7	-3%
Overfunding	9.2	14.6	12.7	18.0	17.1	35%
Repo Capacity	125.6	128.6	128.0	126.3	128.8	1%
<b>Excess Repo Capacity</b>	<b>9.2</b>	<b>14.6</b>	<b>12.7</b>	<b>18.0</b>	<b>29.9</b>	N/A
<b>Average tenor (days)</b>						
Grand Total	25	22	24	25	33	38%
<i>Central Bank Eligible Collateral</i>					26	
<i>Non Central Bank Eligible Collateral</i>					38	
<b>% Repo Book With Maturities &lt;= 1 Week</b>	<b>58%</b>	<b>58%</b>	<b>57%</b>	<b>52%</b>	<b>46%</b>	<b>-11%</b>

*1. Non-traditional repo book excludes Governments, Treasuries, Government/MBS Agencies and Sovereigns*

# Key Liquidity Metrics At Lehman Brothers & Bear Stearns

- ◆ Lehman Brothers had stronger liquidity metrics at the end of Q1 '08 than Bear Stearns
  - 60% greater balance sheet but 130% greater equity
  - Bear Stearns' short-term debt stood at 1.5x its liquidity pool vs. 1.0x for Lehman Brothers
- ◆ Bear Stearns had very few unencumbered assets
  - Half of BSC STD was secured, which might have exacerbated the liquidity crisis in view of the exceptionally low amounts of unencumbered assets
- ◆ Bear Stearns was very reliant on customer free credit balances; if it lost these, it would need to quickly create substantial secured funding capacity for equities at a time when lenders would be likely to pull away
- ◆ Bear Stearns had almost no margin for error in terms of liquidity management. A reduction in short-term debt or in customer free credit balances would leave it in a precarious liquidity position

## Q1 '08 Key Liquidity Metrics (\$billions)

	<u>Bear Stearns</u>	<u>Lehman Brothers</u>	<u>LEH / BSC</u>
Net balance sheet	254	397	1.6x
Net Leverage	22.6x	15.4x	0.7x
Liquidity pool	17	34	2.0x
STD excluding current portion	16	16	1.0x
Current portion of LTD	10	(E) 19	1.9x
Total short-term debt	26	35	1.3x
Short-term debt / Liquidity pool	1.5x	1.0x	0.7x
Unencumbered assets	14	161	11.5x
Free credit balances	43	13	0.3x

# Recent Modifications In Funding Strategy

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- ◆ Since last summer, when the funding and trading environment first became more challenging, we have made a series of modifications in our funding strategy in order to strengthen our liquidity
  - Increased our cash surplus targets from \$2-5 billion to \$4-7 billion
  - Front loaded our issuance program – completed our benchmark issuance plan by early May
  - “Overfund” repos for harder to fund asset classes, such as high yield corporates, to mitigate risk of loss of secured funding capacity
  - Increased our CP program to mitigate risk of operational friction in a very volatile environment
  - Started a program to securitize illiquid assets such as corporate loans and commercial whole loans. The resulting securities, which are rated, can then be pledged to counterparties or Central Banks
  - Discuss our liquidity management and position more proactively with creditors, trading counterparts, rating agencies and other stakeholders
  
- ◆ As a result, we were well prepared to face the extraordinarily difficult funding environment of the week of March 17
  - Started the week with a strong liquidity position
  - Entire Firm was fully engaged in defending the “Liquidity Fortress”
    - Active communication with clients with quick escalation to senior management if necessary
      - Lehman senior management proactively involved in calling their counterparts at key relationships to put pressure on traders who refused to trade with Lehman
    - Great coordination between Front Office, Finance and Operations to minimize any operational friction

## Overview of Q2 '08 Results

# Fixed Income Activities Have Been Driver of Underperformance

While Fixed Income has been affected by significant asset revaluations, challenging trading conditions and de-leveraging, Lehman's other businesses have performed well relative to the prior year

- ◆ We expect our 12 month performance to be consistent with Morgan Stanley and significantly better than Merrill Lynch
- ◆ Core Fixed Income businesses (Rates, Credit, FX) have continued to perform well
- ◆ Segment view includes all writedowns in Fixed Income assets from Investment Management as assets taken out of funds, as well as losses on LBO loans associated with banking activity

## Recent 12 Month Financial Performance

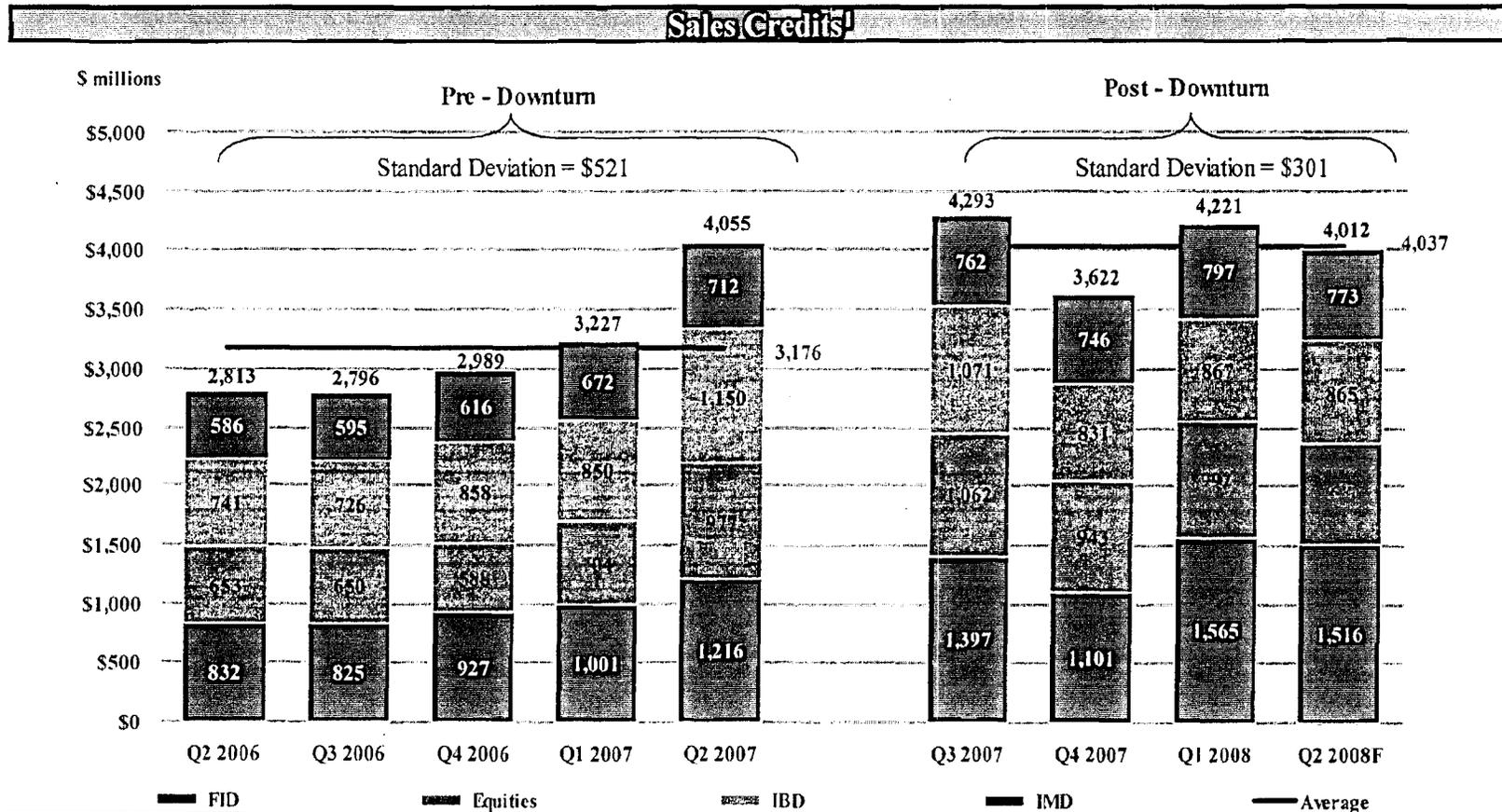
\$ millions	9 Months		Current 12 Months Q3 '07 - Q2 '08	Last 12 Months Q3 '06 - Q2 '07	Current vs. Last Variance	Morgan Stanley 9 Months Q3 '07 - Q1 '08	Merrill Lynch 9 Months Q3 '07 - Q1 '08
	Q3 '07 - Q1 '08	Forecast Q2 '08					
<b>Capital Markets:</b>							
Fixed Income	\$2,183	(\$2,824)	(\$641)	\$8,200	-108%		
Equities	4,661	607	5,268	4,778	10%		
<b>Total</b>	<b>\$6,844</b>	<b>(\$2,217)</b>	<b>\$4,627</b>	<b>12,978</b>	<b>-64%</b>		
<b>Investment Banking:</b>							
Global Finance	1,626	630	2,256	2,609	-14%		
Advisory Services	1,143	235	1,378	975	41%		
<b>Total</b>	<b>\$2,769</b>	<b>\$865</b>	<b>\$3,634</b>	<b>3,584</b>	<b>1%</b>		
<b>Investment Management:</b>							
Asset Management	1,609	496	2,104	1,593	32%		
Private Investment Management	983	356	1,339	1,115	20%		
<b>Total</b>	<b>\$2,592</b>	<b>\$852</b>	<b>\$3,443</b>	<b>2,708</b>	<b>27%</b>		
<b>Total Net Revenues</b>	<b>\$12,205</b>	<b>(\$500)</b>	<b>\$11,705</b>	<b>19,271</b>	<b>-39%</b>	<b>\$15,830</b>	<b>(\$5,398)</b>
Compensation and Benefits	6,129	2,300	8,429	9,501	-11%	10,854	10,453
Non-personnel Expenses	2,978	1,095	4,073	3,335	22%	6,301	6,399
<b>Total Expenses</b>	<b>9,107</b>	<b>3,395</b>	<b>12,502</b>	<b>12,836</b>	<b>-3%</b>	<b>17,155</b>	<b>16,852</b>
Pre-tax Income / (Loss)	3,098	(3,895)	(797)	6,435	-112%	(1,325)	(22,250)
Taxes	836	(1,285)	(449)	2,095	-121%	(761)	(7,379)
<b>Net Income</b>	<b>\$2,261</b>	<b>(2,610)</b>	<b>(\$349)</b>	<b>4,340</b>	<b>-108%</b>	<b>(494)</b>	<b>(14,036)</b>
ROE	14%	-56%	-2%	24%			

1. Includes investments in minority stakes

# Core Sales Credits Are Still Strong...

Lehman's sales credits, which are the majority of the capital markets run rates (historically around 80%), have done well during the economic downturn, and have actually been less volatile during this period

- ◆ Lehman's sales credits in Q2 '08 were strong in a particularly difficult economic environment, down only 5% from Q1 levels, and 1% year-over-year



1. Represents Fixed Income and Equities Sales Credits as well as Investment Banking and Investment Management client revenues represent fees

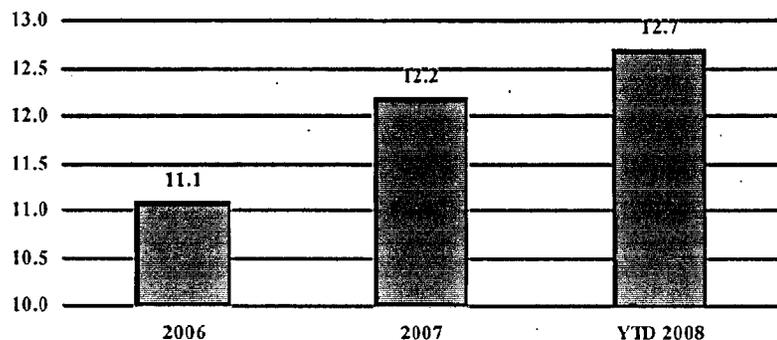
LEHMAN BROTHERS FID - repackaging business much smaller 19

Commodities are in FID  
Eagle Energy  
invested regionally, with infrastructure, Treasury risk mgmt

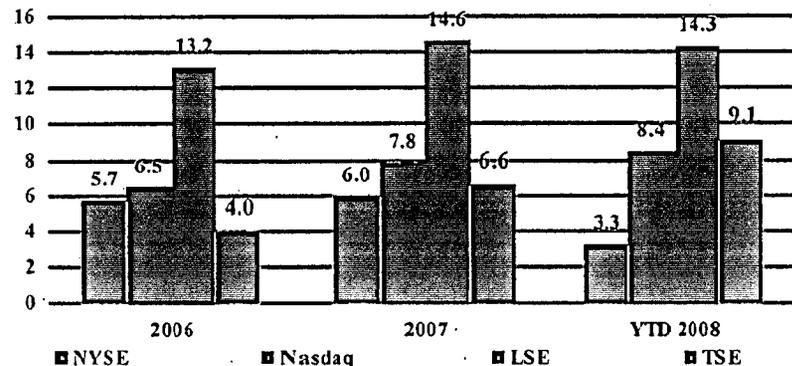
# ...And Lehman Gaining Market Share in A Weak Market...

We continue to increase our market share in all corners of Origination<sup>1</sup> and Trading<sup>2</sup>, highlighting the strength of our client franchise in difficult markets

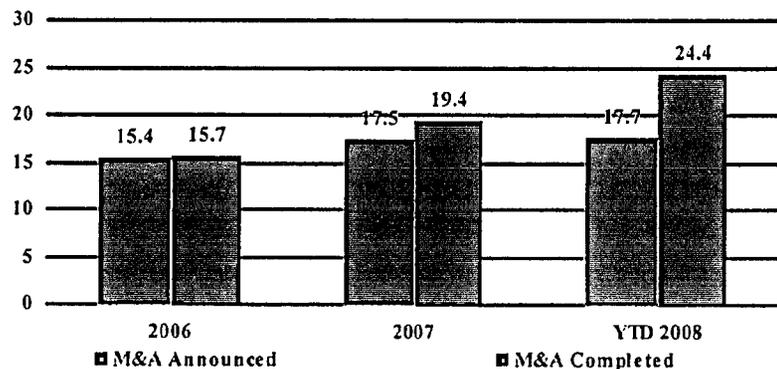
**Fixed Income Trading Volume (%)**



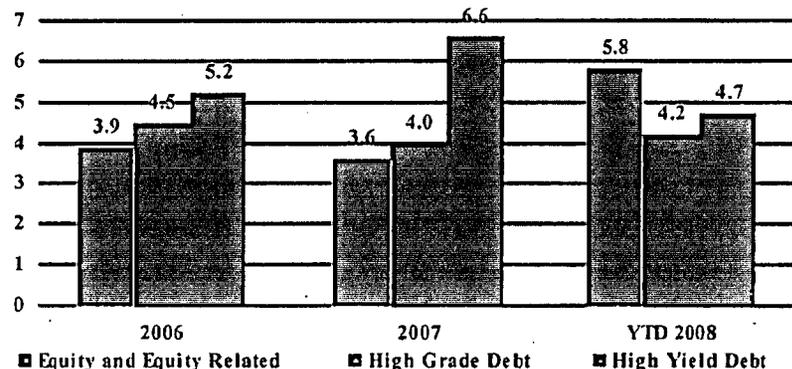
**Equity Trading Volume (%)**



**M&A (%)**



**IBD Capital Markets (%)**



1. Thomson Financial; all data is calendar year, YTD is through May 30, 2008  
 2. Fixed Income - Federal Reserve; all data is fiscal year, YTD is through May 14, 2008; Equity - Applicable exchanges and Lehman Brothers; all data is calendar year, YTD is through Mar 31, 2008

# ...With Strong Franchise Gains in Investment Banking

Lehman is achieving significant market share gains in a challenging environment

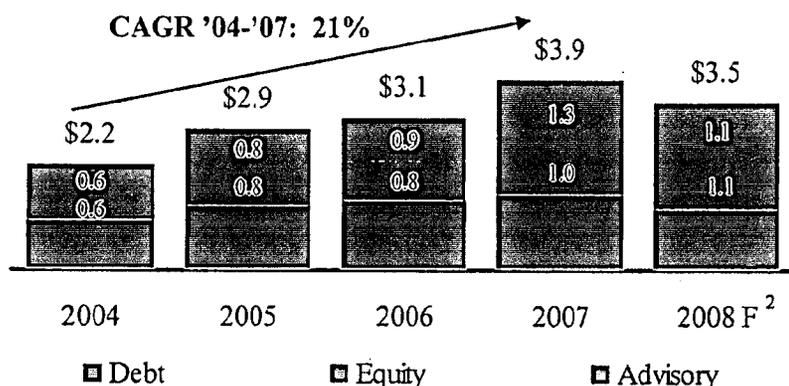
## Investment Banking Market Share<sup>1</sup>

Global	2006	2007	YTD 08
M&A Announced	15.4%	17.5%	17.7%
M&A Completed	15.7%	19.4%	24.4%
Equity & Equity Related	3.9%	3.6%	5.8%
High Grade Debt	4.5%	4.0%	4.2%
High Yield Debt	5.2%	6.6%	4.7%

## Franchise Momentum<sup>1</sup>

- ◆ Leadership in strategic M&A and financial sector restructuring
  - \$4.5 billion equity and convertible preferred issuance for FNMA
  - \$7.0 billion equity and convertible issuance for Washington Mutual
  - As well as issuances for CIT, AIG, MBIA and regional banks
- ◆ #3 in U.S. and # 1 in Asia (ex-Japan) announced M&A
- ◆ Advised on the 2 largest announced M&A transactions of the year and 3 of the top 4 completed deals
  - \$109.0 billion Phillip Morris International spin-off
  - \$42.0 billion hostile bid by Microsoft for Yahoo
  - \$21.0 billion acquisition of Imperial by Altadis
  - \$15.0 billion Sprint Nextel / Clearwire transaction
- ◆ Increased focus on corporate derivatives (10% and 14% of Investment Banking revenues in FY06 and FY07, respectively)

## Investment Banking Revenues



1. Market share based on year-to-date Thomson data as of May 31, 2008  
 2. 2008 data actual through April and annualized thereafter

# Conclusion

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- ◆ Current quarter has been affected by significant writedowns without the benefit of the hedges performing
- ◆ Additionally, basis losses incurred in the credit areas and trading losses in the rates business are from largely technical and outsized movements.
- ◆ Writedowns are smaller than previous quarters and traded volumes suggest that support levels are strong for these asset classes, reducing the risk of further losses
- ◆ The revenue run rate has been resilient with client flow affected by overall market turbulence in March
- ◆ Capital position is stronger than ever with de-levering bringing both net and gross leverage ratios to multi-year lows.
- ◆ Liquidity position at record levels though debt and capital raises, de-levering, asset transformation, leveraging our Banks and operational improvement
- ◆ Overall creditworthiness looking forward is strong, but actively considering common equity raise