*Confidential* ***Presentation to:***

# Executive Committee

# Leveraged Finance Risk

***October 16, 2007***

LEHMAN BROTHERS

# Table of Contents

# Executive Summary

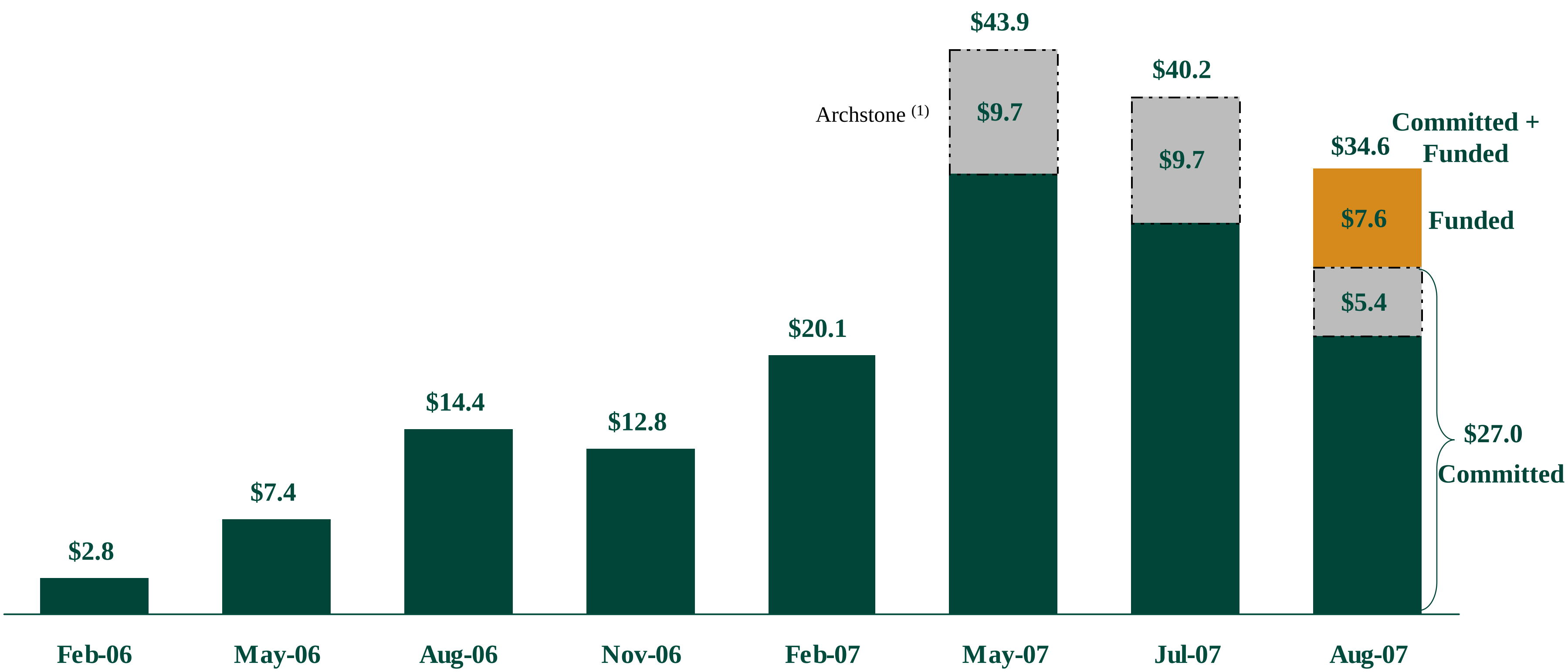
- To come, e.g.,
  - What happened
  - Lessons learned
  - How to allocate going forward

## I. Update on the Firm’s Leveraged Finance Pipeline and its Comparative Size

# High Yield Commitments – Lehman Brothers 10Q

**Reported a record $43.9 billion in High Yield contingent commitments in 2Q 2007**

**High Yield Contingent Acquisitions Commitments as Reported in 10Qs ($B)**

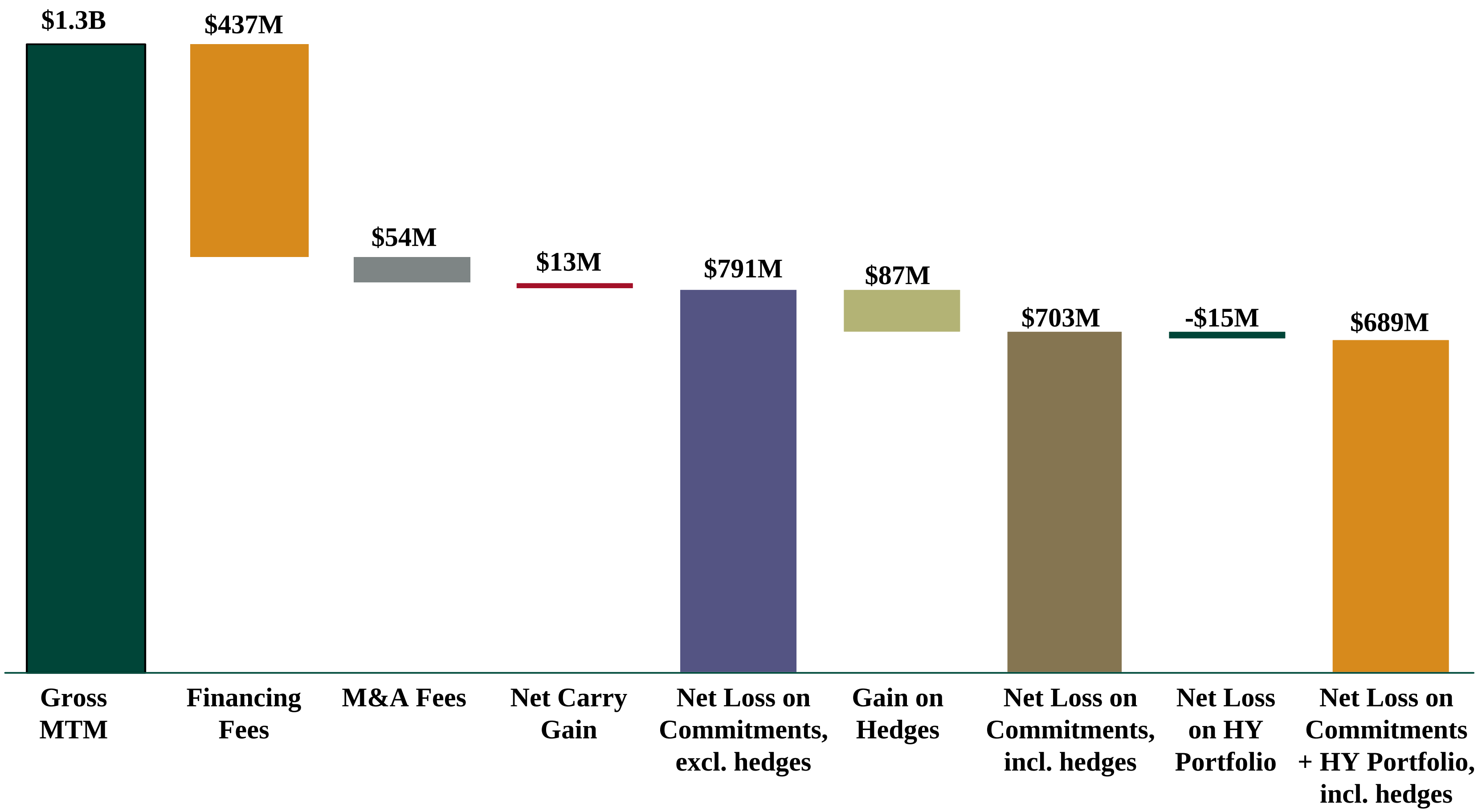



*(1) Archstone commitment totaled $11.1B, of which $9.7B was debt ($8.55B debt + $1.15B junior mezzanine), $1.15B was Bridge Equity and $0.25B is permanent equity*

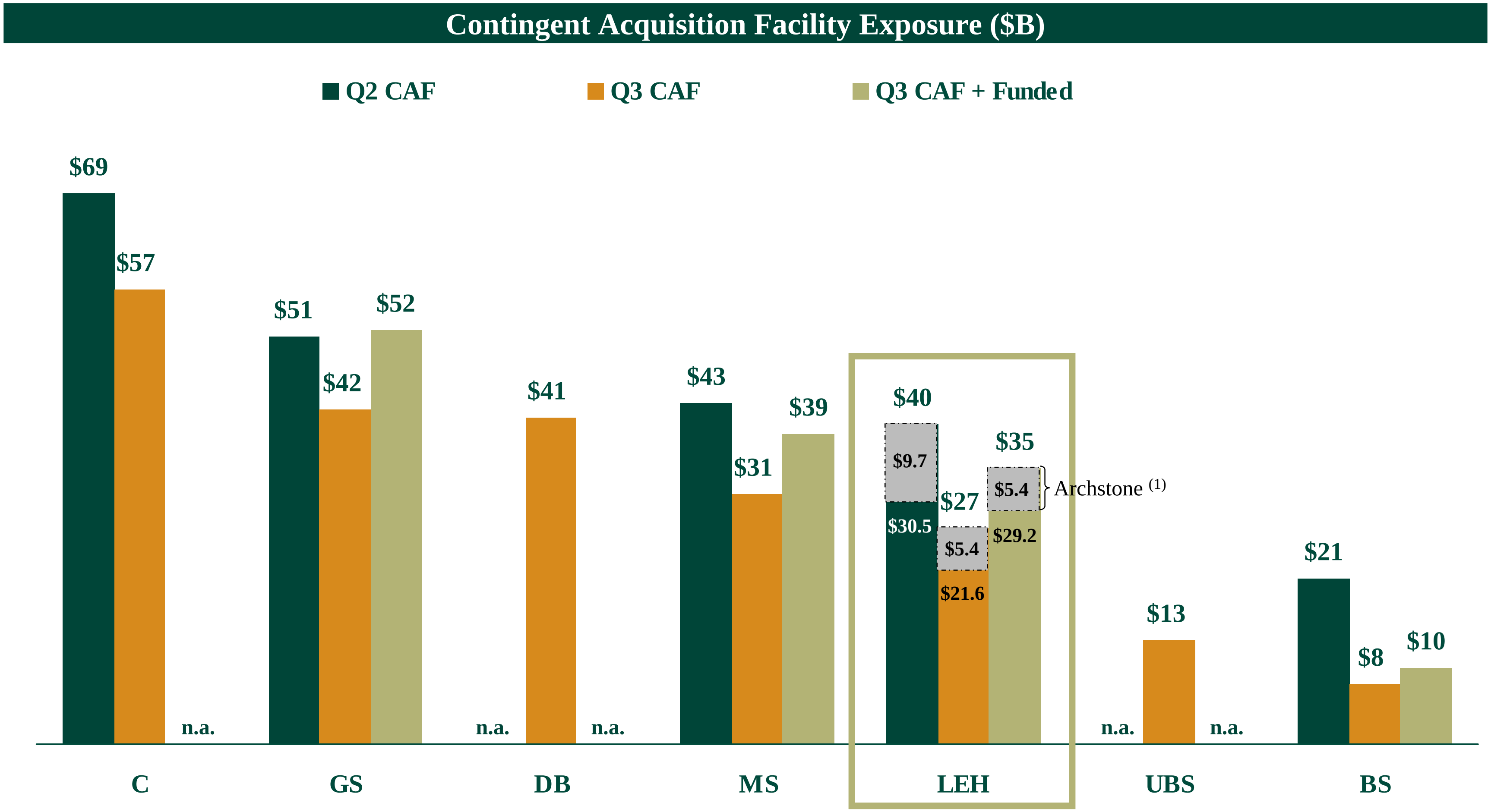
# P&L Impact of HY Facilities – Lehman Brothers

**Overview of MTM Losses through August 31**

- **Add revisions since 8/31 (e.g., First Data, PHH) – requested from FID Product Control**



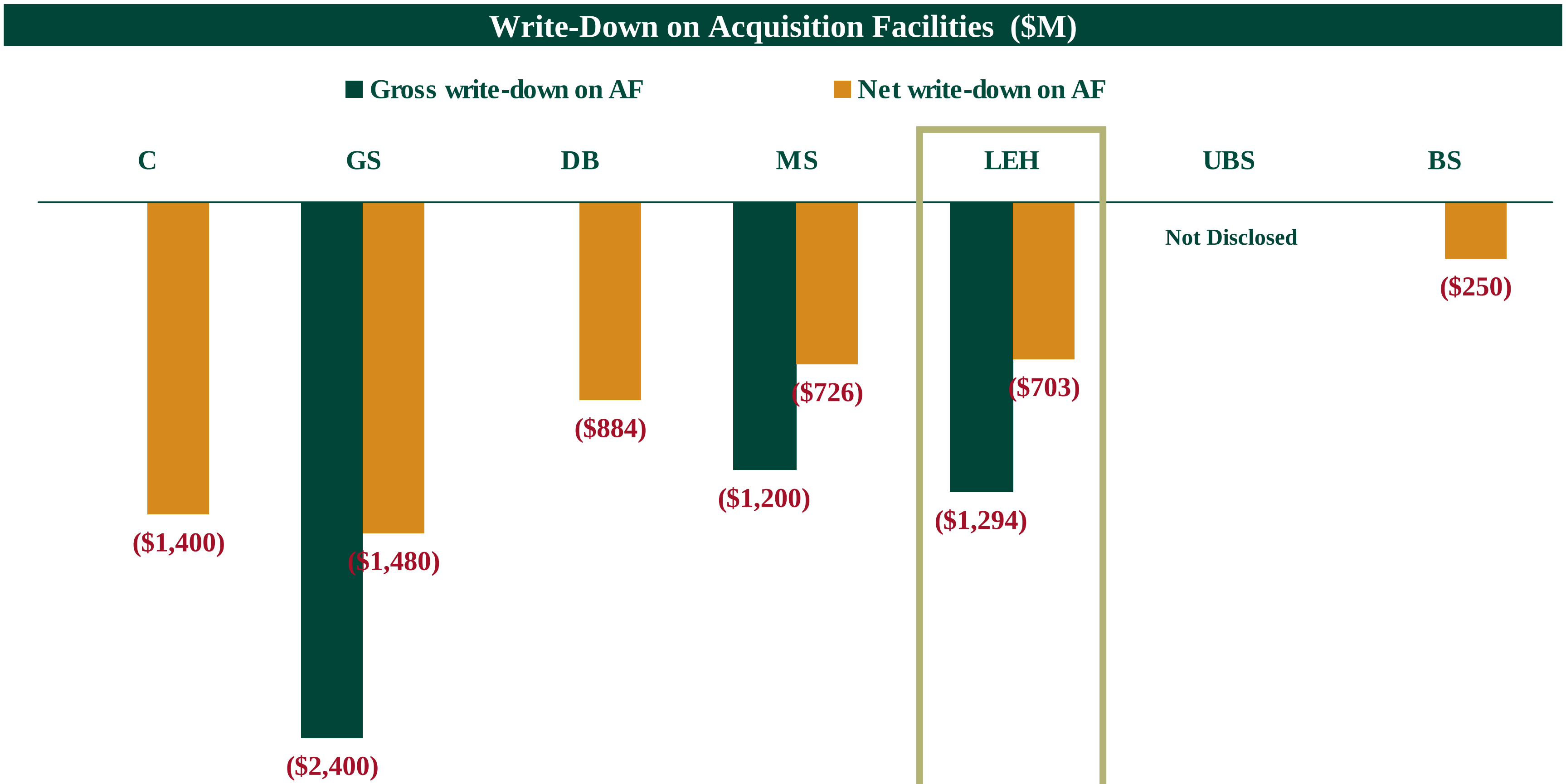
# High Yield Commitments – Competitor Comparison




*(1) Archstone commitment totaled $11.1B, of which $9.7B was debt ($8.55B debt + $1.15B junior mezzanine), $1.15B was Bridge Equity and $0.25B is permanent equity*

*Note: UBS and Citigroup's figures were taken from press releases prior to official 3Q earnings announcements; as a result, it is unclear whether CAF portfolio contains exactly the same inputs as the other firms*

# P&L Impact of HY Acq. Facilities – Competitor Comparison



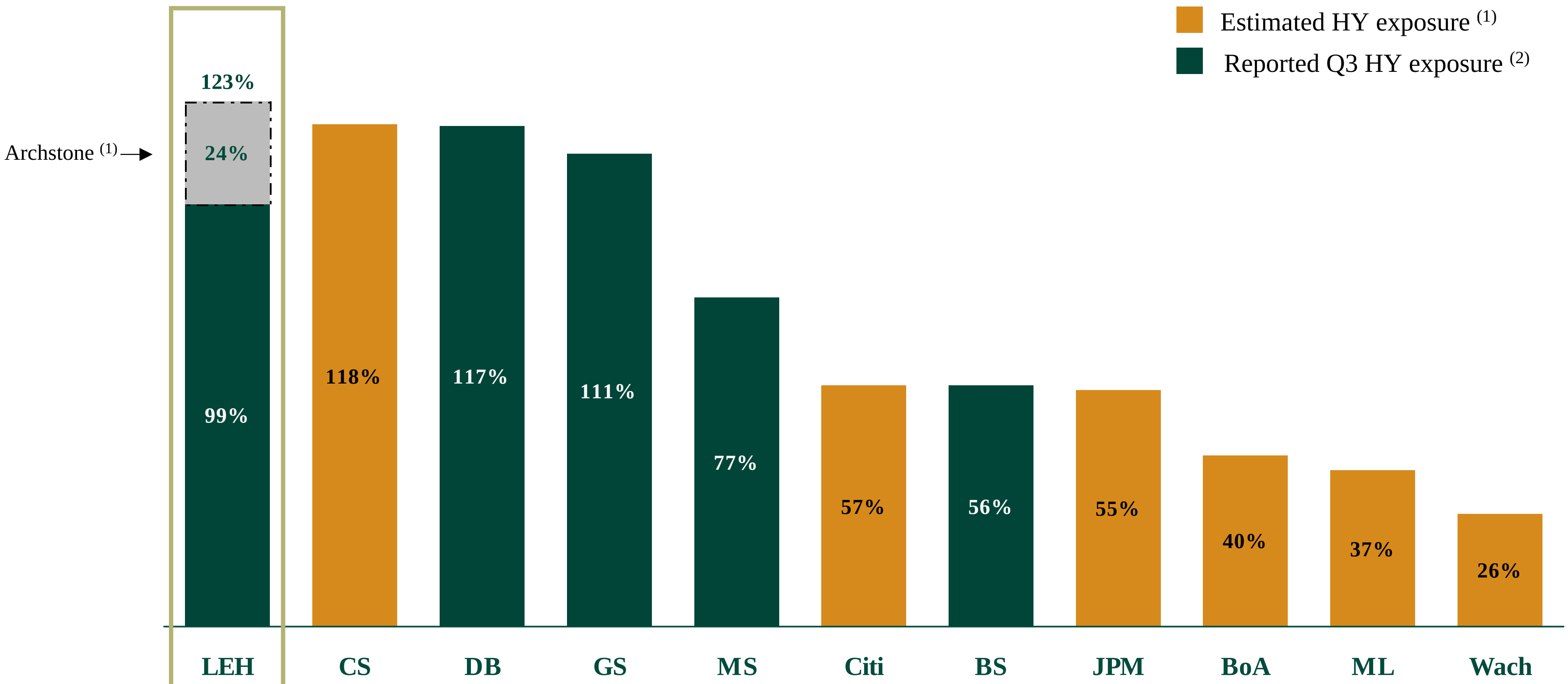

| | C | GS | DB | MS | LEH | UBS | BS |
|---|---|---|---|---|---|---|---|
| **Net Write-Down as % of Outstanding Commitment:** | 2.5% | 3.5% | 2.2% | 2.3% | 3.3%[1] | N/A | 3.3% |

*Note: UBS and Citigroup's figures were taken from press releases prior to official 3Q earnings announcements; as a result, it is unclear whether CAF portfolio and write-down figures contain exactly the same inputs as the other firms*

*(1) Net number for LEH excludes Archstone commitment*

# High Yield Commitments as Percentage of Leverage Equity

## Estimated Amount of Bridge and Loan Risk Exposure as a Percentage of Leverage Equity [3]



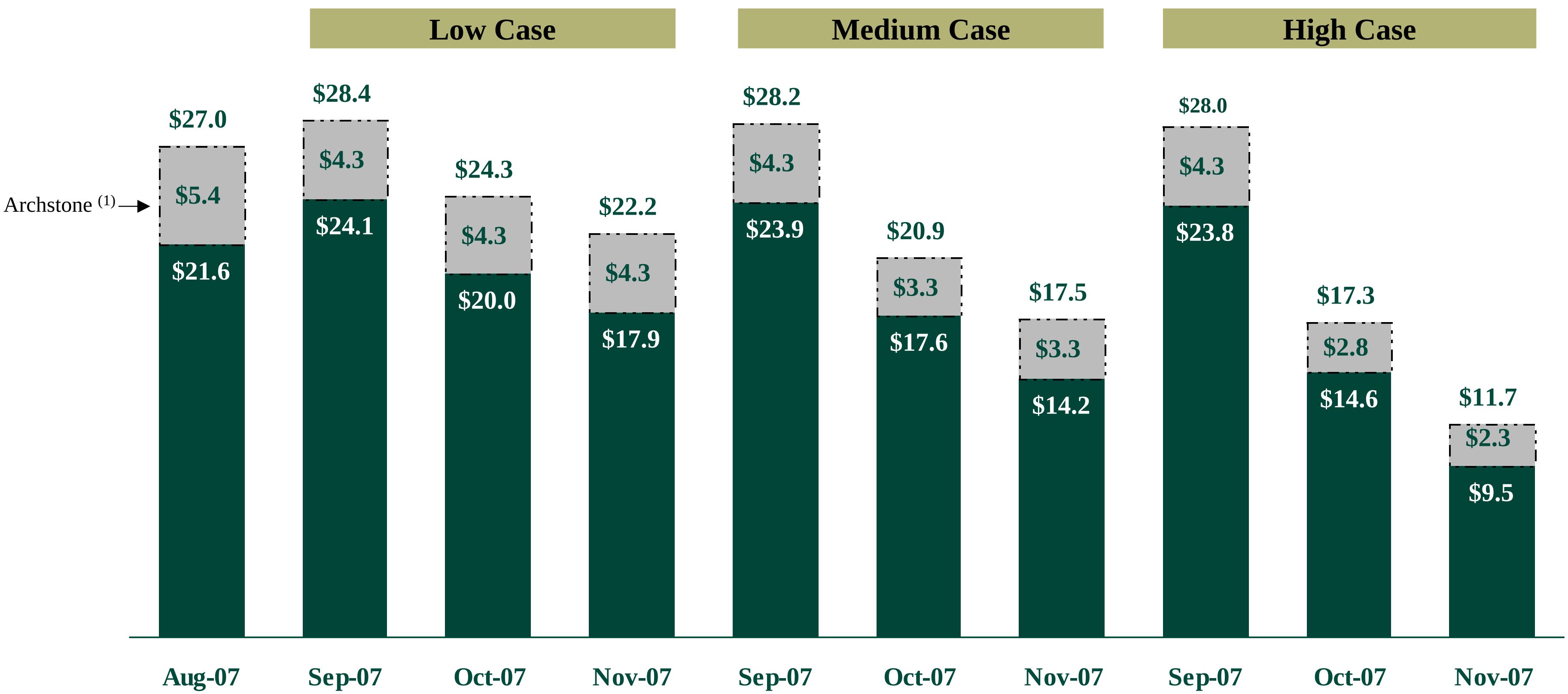

| | LEH | CS | DB | GS | MS | Citi | BS | JPM | BoA | ML | Wach |
|---|---|---|---|---|---|---|---|---|---|---|---|
| HY Exp. | $27B | $37B | $41B | $42B | $31B | $55B | $8B | $49B | $38B | $16B | $11B |
| Lev Equity | $22B | $31B | $35B | $38B | $40B | $97B | $13B | $88B | $95B | $43B | $42B |

1. *Loans estimated based on reported public forward calendar as of mid-July. Does not account for total forward calendar where deal size or underwriter information was not available.*
2. *Reported CAF for Q3.*
3. *Leverage Equity defined as Tier 1 + 2 capital. Q2 data for all competitors.*

# Lehman Brothers Projected High Yield Syndication

## Projected High Yield Contingent Acquisitions Commitments ($B)

***$ in billions, does not include funded positions***




| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **% Loans[2]:** | 76% | 75% | 73% | 71% | 75% | 70% | 75% | 75% | 66% | 84% |

*(1) Archstone commitment totaled $11.1B, of which $9.7B was debt ($8.55B debt + $1.15B junior mezzanine), $1.15B was Bridge Equity and $0.25B is permanent equity*
*(2) Loans, as a percentage of total commitments, including Archstone*

## II. Changes in the Leveraged Finance Market

# Recent Trends in Restructured Commitments

| Issuer | Sponsor | Size | Lehman's Role | Added / Improved Covenant(s) | Elim. / Alt. PIK Toggle | Commit. Size Altered | Rate Relief | Soft Call | Retranching | Underwriter's Leverage for Renegotiation |
|---|---|---|---|---|---|---|---|---|---|---|
| TXU | KKR, TPG, Citi, Goldman | $30.7B | Joint Bookrunner | ✓ | | | ✓ | | | Credit Agreement |
| First Data | KKR | $24B | Joint Bookrunner | ✓ | ✓ | | | | ✓ | Limited |
| Home Depot Supply | Bain, Carlyle, CD&R | $9.8B | Joint Bookrunner | | ✓ | ✓ | ✓ | | ✓ | Business MAC |
| Allison | Carlyle, Onex | $4.6B | Joint Bookrunner | ✓ | | | | | | Limited |
| Goodyear EPD | Carlyle | $1.3B | Lead Bookrunner | ✓ | | | | | ✓ | Limited |
| Targa | Warburg Pincus | $2.5B | Joint Bookrunner | | | ✓ | ✓ | | ✓ | Limited |
| Jarden | Warburg Pincus | $900M | Lead Bookrunner | ✓ | | | | | ✓ | Limited |
| Asurion | MDP, WCAS, Providence | $2.4B | Lead Bookrunner | | | | ✓ | | | Limited |
| USIS | Providence | $1.3B | Lead Bookrunner | ✓ | ✓ | | | | | Limited |
| Alliance Atlantis CW Media | GS Capital, Canwest | $950M | Joint Bookrunner | ✓ | ✓ | | ✓ | | | Condition precedent not met |
| R.J. O'Brien | Spectrum, Tech Crossover Ventures | $685M | Lead Bookrunner | ✓ | ✓ | | | | | Limited |
| Vertrue | One Equity | $660M | Lead Bookrunner | ✓ | | | ✓ | ✓ | | Limited |
| Syniverse | GTCR | $500M | Lead Bookrunner | ✓ | | | ✓ | ✓ | ✓ | Limited |

# Lessons Learned

- Need contractual protections in commitment letters
  - Sponsors can, and will, hold us to any terms and conditions that we sign
  - Verbal agreements were ‘forgotten’ by sponsors
  - Only speak for what we’re willing to take
- Concessions correlated with the degree of leverage underwriters have
- Credit agreement negotiations are our last line of defense
  - Maximum flex in credit agreements is critical
- Business MAC provisions matter: negotiate to keep them and pay attention to wording
  - Rely on specific financial conditions whenever possible, i.e., minimum EBITDA and maximum leverage
- Tougher to negotiate rate concessions on financings that had already been restructured from cov lite and PIK toggle
- Staples can be dangerous if not handled correctly, can force the Firm into unwanted financing commitments
- Difficult to risk manage financings when we have a non-lead manager role
  - If we’re going to be on the right side, should try to minimize commitment on large transactions
- Too much dependence on leveraged buyers
  - Don’t estimate significant supply / demand dynamics of the overall market
- SMA round commitments may not transfer risk – need to tighten up agreements and make them more robust
  - Make it a priority to transfer risk ASAP
- Size matters: deals can be too big as the market has limited capacity
- Bridge Equity market not nearly as deep as Financial Sponsors claimed

# III. Future Management of Capital Commitments

# Future Management of Capital Commitments

## Better Allocation of Capital and Return on Risk

1. Institute hard limits for single transactions and total portfolio exposure
2. Insist on bookrunner and M&A roles
3. Commit to lower percentages and amounts on large deals
4. Limit commitments of longer duration
5. Evaluate and prioritize Financial Sponsor relationships
6. Tighten underwriting standards by establishing specific boundaries
7. Do not manage staple financings as aggressively
8. Limit Bridge Equity
9. Sell-down risk through non-traditional means
10. *Grow Balance Sheet to permit higher level of commitments*

# Single Transaction and Total Portfolio Limits

**To be confirmed by Chris O'Meara and team**

***Institute hard limits for single transactions and total portfolio exposure***

- Institute appropriate limits for the following: Single Transaction Limit (STL), portfolio limit and funded position limit
- High Yield transactions must be below the following limits:
  - Recommended STL for notional value of High Yield transactions: **$2.5 billion**
    - Notional value subject to STL is expected commitment, not amount for which the Firm originally signs
  - Recommended new STL for modeled losses resulting from any High Yield or High Grade transaction: **$400 million** (1)
    - Equivalent to approximately $2.3 billion 'B' rated LBO commitment (2)
- Proposed Notional Portfolio Limit: **$25 billion** for HY Contingent Commitments + HY Funded Positions
  - Once the Firm reaches a steady state, allows for addition of $5 billion of new commitments per month, assuming average tenor of commitment of 4 months, plus $5 billion of funded positions
  - Limit based on "headline" exposure
  - Also should limit modeled loss on the portfolio to **[$  billion]** at 99.5% confidence interval
    - Size estimated loss for each position in the portfolio using STL framework
    - Apply diversification benefit
- Proposed Funded High Yield Position Limit: **$1 billion**
  - [Ensure that the Firm is not exposed to any one credit rated below BBB for >$1 billion, in the event of fraud]
  - [Must address issues arising from the disparity between $2.5 billion notional limit and $1 billion funded limit]

**Implications**

- Limits our ability to participate in many transactions, especially larger ones
- Makes the Firm much less relevant to major Financial Sponsors
  - Especially to top ten Diamond accounts

(1) *Assumes STL model includes the new risk factors that Risk Division has proposed. The new factors are roughly half of the old, implying a spread widening of 50 bps to 900 bps depending on the riskiness of the deals. These scenarios are in line with '98 and '02 type of widening in the course of a few months.*

(2) *Assumes standard terms on the commitment: B rated loan, Caa bridge, no Bridge Equity, no put bond, 2/3 are loans and 1/3 are bonds, and long time horizon for deal to get approved, and no MAC. With a 150 bps put bond cushion, the limit moves up to $2.5B.*

# Insist on Bookrunner and M&A Roles

***Focus on deals where Lehman has a leading M&A / strategic role***

- Limited exceptions to proposed underwriting guidelines where Lehman is not receiving a meaningful M&A fee (at least $10 million) and a lead role in the transaction
  - Exceptions will depend on the nature and extent of the relationship with the Financial Sponsor/Borrower
- De-emphasize tag-along financing roles in auctions
  - Decline to bid where roles and economics are already set
- No FRL loans to credits for which the Committee is unwilling to be a lead underwriter at the proposed FRL terms

**Implications**

- Many sell-side M&A mandates require provision of staple financing

# Commit to Lower Percentages and Amounts on Large Deals

***Sign for lower percentages and amounts on any single large deal***

- Do not insist on equal participation
- Reduce financing economics to manage risk
- Willingness to give up the left as long as the Firm maintains a lead arranger or bookrunner role
- When we do not have a lead role, reduce percentage committed

**Implications**

- No longer driving the discussion on terms or leading the syndication of financing
- Risk of getting eliminated altogether from the deal, rather than ending up with a smaller share
- No pro rata sell-down
- Impact on the Firm's economics and league table position

# Limit Commitments of Longer Duration

***Manage the commitment inventory down by limiting commitments of longer duration***

- Be mindful of expected life of each commitment
  - Cost of a commitment increases as it remains in our inventory for a longer period, especially since longer commitments rarely generate higher fees
  - Need to keep turning inventory to maximize return on capital and make room for new commitments

- Apply higher standards for longer-duration commitments
  - Demand more pricing flex and higher put bond rates
  - Require higher fees

- Limit commitments in transactions requiring long regulatory approval processes, e.g., Univision, TXU

**Implications**

- Reduce Leveraged Finance activity in regulated industries, such as Media and Power
- Reduce our ability to manage the Firm's risk exposure as we will not be in a position to negotiate terms or control syndication strategy

# Financial Sponsor Relationships

***Evaluate and prioritize Financial Sponsor relationships***

- Need to maintain a scorecard of Financial Sponsors' actions on each transaction
  - Track which Financial Sponsors have shown pricing and structural flexibility, thereby helping the Firm syndicate the risk instead of sticking with the specific terms laid out in the documents and forcing the Firm into funded Bridge Loans
- Emphasize relationships with Financial Sponsors who treat the Firm as a valued advisor and partner, rather than as a provider of commodity financing
- Re-evaluate business with those Financial Sponsors who are looking to compete with us in our customary businesses
- Re-evaluate contractual commitment standards, including protection provided by stipulations in the fee letter

**Implications**

- Allocate financial and human capital to our best Financial Sponsor relationships
- Limit business with Financial Sponsors with bad track records, which may reduce the Firm's involvement in larger transactions and therefore decrease our revenues and lower our league table standing
  - However, may increase Lehman's share of the fee pool on a risk-adjusted basis

# Tighter Underwriting Standards

***Tighten underwriting standards through establishment of specific boundaries***

- Boundaries will change based on then-current market conditions and demands

- Relevant considerations:
  - Use of proceeds
  - Leverage multiples and Free Cash Flow
  - Ratings
  - Covenants
  - PIK Toggle
  - Cushion and flex
  - Delayed draw facilities

**Implications**

- Will lose out on deals when other banks are more aggressive on terms

# Staple Financings

***Don't manage staple financings as aggressively***

- When providing staple, do not stretch on terms and structure to pre-empt competitive financing proposals
  - Make M&A advisory role our top priority, but retain option to participate in financing if we are comfortable with the terms
- Do not limit bidder's opportunity to bring in other sources of financing
- Do not allow sell-side M&A client to push the Firm into financings with which we are not comfortable
- Address conflict of interest issues
- When acting as lead M&A advisor for sale of a public company, do not provide staple

**Implications**

- Limit the Firm's ability to "lock-up" a financing role when acting as sell-side advisor
- Lose exclusive sale mandates when seller demands staple financing and indicative staple terms are a key factor in awarding the mandate, e.g., for Financial Sponsor portfolio companies
- Reduce the Firm's fees and league table position in Leveraged Finance and Sponsors M&A

# Limit Bridge Equity

***Make a strategic decision to limit Bridge Equity***

- Only provide Bridge Equity when the Firm is comfortable enough with the credit to co-invest in the equity and then, only for an incremental amount beyond the co-investment commitment

- Insist on priority sell-down on marketable terms, i.e., no promote

**Implications**

- Could limit our participation in larger transactions
- Could impact our access to co-invest opportunities

# Sell-Down Risk Through Non-Traditional Means

***Silent Participation Sales***

- Continue Silent Participation Sales with Sumitomo and Commerzbank; seek to develop additional Silent Partners
- Major components of Risk Share arrangement:
  - Transactions shown and approved on a deal-by-deal basis
  - Partner takes 10% to 30% of Lehman's risk on a pro-rata basis
  - Risk sharing done on a silent basis, Partner still able to separately participate directly as a Senior Managing Agent
  - Fees from financing are shared with Partner; Lehman to receive a "Placement Fee" for sourcing/structuring deals
    - When placement fee is incorporated, a Partner taking 25% of the Risk would obtain approximately 15% of the fees (1)
- Reservations from other potential risk sharing partners:
  - Reluctance to take large size (≥$100M) leveraged loan exposure
  - Strong preference to tell Financial Sponsors about involvement as a means to expand their Financial Sponsor relationships
- This program will have a natural negative selection bias on the credit quality of the remaining portfolio
  - Partners may have certain borrower, sector, leverage or rating based limitations, leading them not to participate in all deals

| Potential Risk Share Partners | Considering Specific Deals | Signed Confi | Presented Idea | Completed Trades |
|---|---|---|---|---|
| SMBC | ✔ | ✔ | ✔ | EPCO ($400M), Bulk (~$2,360M) |
| Commerzbank | | | ✔ | EPCO ($700M), Various LCDS (~$1B), AES ($60M), Idearc ($60M), Dynegy ($40M), Enterprise ($250M), Sprint ($225M), High Mount ($121M) |
| Bank of Scotland | | | ✔ | Las Vegas Sands ($98M), Boyd Gaming ($62M) |
| Royal Bank of Canada | | | ✔ | |

**Implications**

- Must bear the cost of risk mitigation by transferring a meaningful portion of the Firm's projected fees
- Natural negative selection bias reduces the credit quality of the remaining portfolio

1. *On a $4B Lehman commitment (with standard fees) a 75% / 25% split produces projected fees of 100 bps -125 bps to Lehman and 75 bps – 100 bps to Partner (assuming no OID).*

# Sell-Down Risk Through Non-Traditional Means

***Transparent Underwriting Program***

- Develop Transparent Underwriting Program with Sumitomo, GECC, RBC and any other potential partner
  - Other institutions commit to 25%+ of gross initial commitment shortly after the Lehman commitment
  - Require transfer of a portion of the acquisition financing related fees
  - Objective is to establish a regular program of commitments to develop confidence that the Firm can regularly reduce our High Yield commitment exposure
  - This strategy runs client risk for the following reasons:
    - Financial Sponsors prefer that their lead lenders maintain the full exposure
    - Facilitating a new lending relationship for our Financial Sponsor clients

**Implications**

- Must bear the cost of risk mitigation by transferring a meaningful portion of the Firm's projected fees
- May impact the Firm's relationships with Financial Sponsors

# Grow Balance Sheet to Permit Higher Level of Commitments

***Balance Sheet Expansion***

- How much would our Balance Sheet need to grow for the Firm to be comfortable with a run rate of $50 billion in mandated High Yield commitments (as opposed to the current proposal of $20 billion)?

- What steps should the Firm take to grow the Balance Sheet?
  - What other implications would these steps have?

- Expanding Balance Sheet gives rise to competing demands for its use
  - How should the Firm balance the ability to maintain higher levels of Leveraged Finance lending commitments with our other priorities?

## IV. Impact on Investment Banking Revenue Growth

# Impact on Investment Banking Revenue Growth – Projected Capital Commitment Scenarios

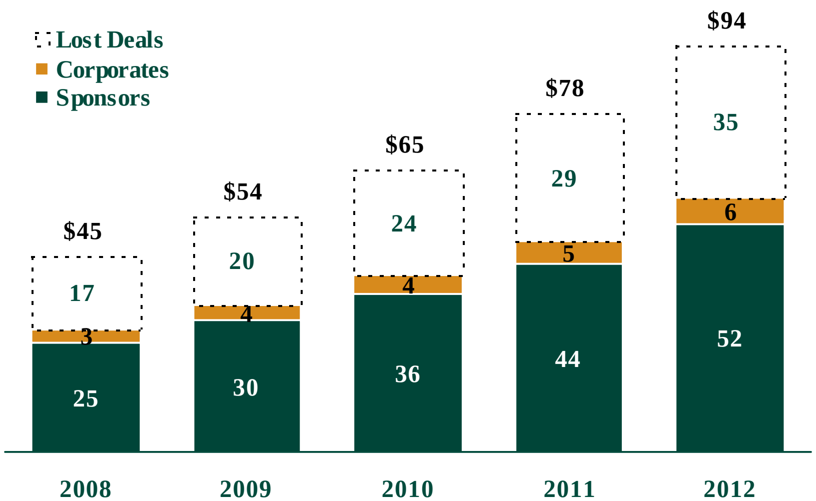
To be revised

| | Scenario 1 – Drive Revenue Growth | Scenario 2 – Capital Management |
|---|---|---|
| 2012 Capital Commitments | ◆ $58 billion for mandated commitments<br>◆ $94 billion including contingent commitments | ◆ $25 billion for mandated commitments<br>◆ $40 billion including contingent commitments |
| 2012 Revenue | ◆ Grow LevFin revenue at 20% annually from $1.0B in 2007 to $2.5B in 2012<br>◆ Investment Banking revenue grows 16.6% from $4.1B to $8.8B in 2012 ($6.5B in 2010) | ◆ Grow LevFin revenue at 1% annually from $1.0B in 2007 to $1.1B in 2012<br>◆ Assume Sponsors ECM and M&A share will decline given LevFin pullback (assume 12% vs. 17% growth in scenario 1)<br>◆ Investment Banking revenue grows 9% from $4.1B to $6.3B in 2012 ($5.3B in 2010) |
| Benefits | ◆ Meet Investment Banking's revenue target<br>– Improve market share in all products<br>◆ Remain relevant to leading Financial Sponsors<br>– Ability to win mandates for largest deals<br>◆ Positioned well to drive discussion on terms and to lead syndication<br>◆ Positioned well to win follow-on mandates (e.g., IPO, M&A advisory, Derivatives)<br>◆ Access to attractive co-investment opportunities | ◆ Risk exposure is limited |
| Issues | ◆ Potential implications of risk exposure<br>– Mark-to-market losses which increase earnings volatility<br>– Increased cost of funding for the Firm<br>– Pressure on Corporate Ratings<br>– Liquidity pressure from unexpected large fundings<br>– Regulatory capital increase | ◆ Become less relevant to leading Financial Sponsors<br>– Positioned poorly to win follow-on mandates<br>– Limited access to co-investment opportunities<br>◆ To meet Banking growth target, M&A and ECM would have to generate an incremental $6.7B in fees in aggregate from 2008- 2012<br>◆ For ECM and M&A in aggregate to fill that gap, would need CAGR of 22%+ and incremental market share gain of ~4%<br>◆ If ECM and M&A are not able to fill the gap, Lehman's global Investment Banking rank will decline<br>– Slow growth in Banking may impact Lehman's valuation |

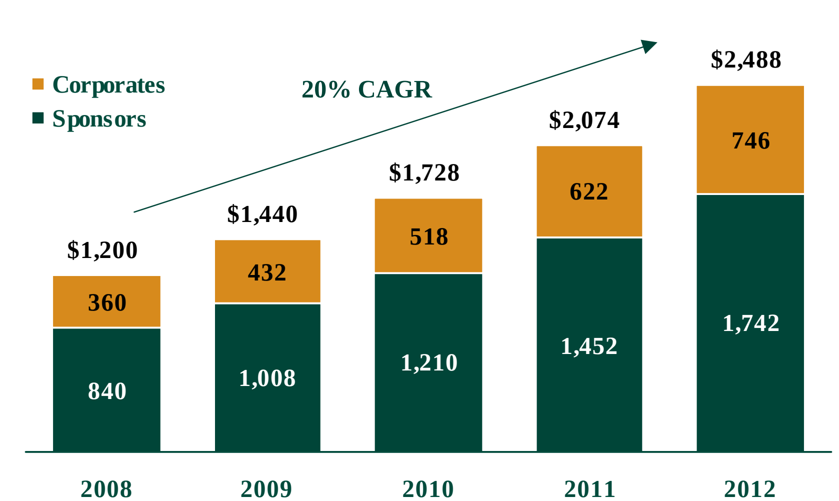
# Projected Capital Commitment Scenarios – Detail

## Scenario 1 – Drive Revenue Growth (Leveraged Finance Revenue Growth of 20%)

### Capital Commitments (1) ($B)

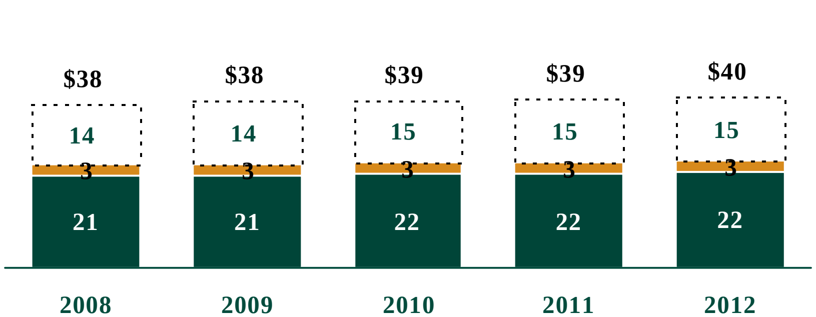



### Leveraged Finance Revenue (2) ($M)

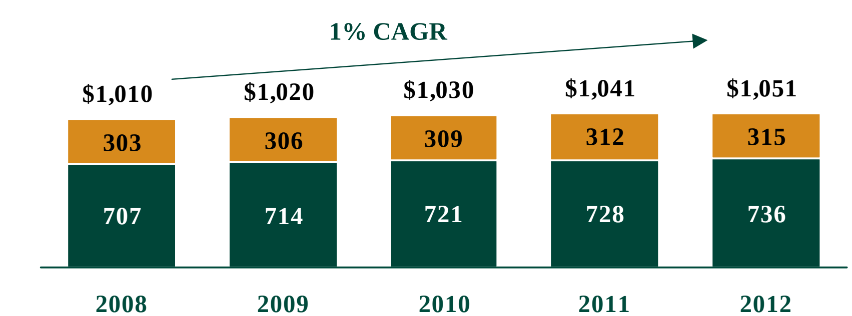



## Scenario 2 – Capital Management (Limit Mandated Capital Commitments to $25B)

### Capital Commitments (1) ($B)




### Leveraged Finance Revenue (2) ($M)




*(1) Projecting mandated, rather than contingent, commitments (not just 10Q reporting). Assume 40% win percentage on contingent commitments, so capital requirements are 60% higher. Average inventory turnover: Sponsors: 2.5 turns per year for loans and bonds and Corporates: 6 turns a year for loans and 8 for bonds.*

*(2) Assume revenue split: 70% Financial Sponsors / 30% from Corporates. Fee assumptions: 50% loans (1% return), 50% bonds (2% return).*

# Revenue Implications for Investment Banking

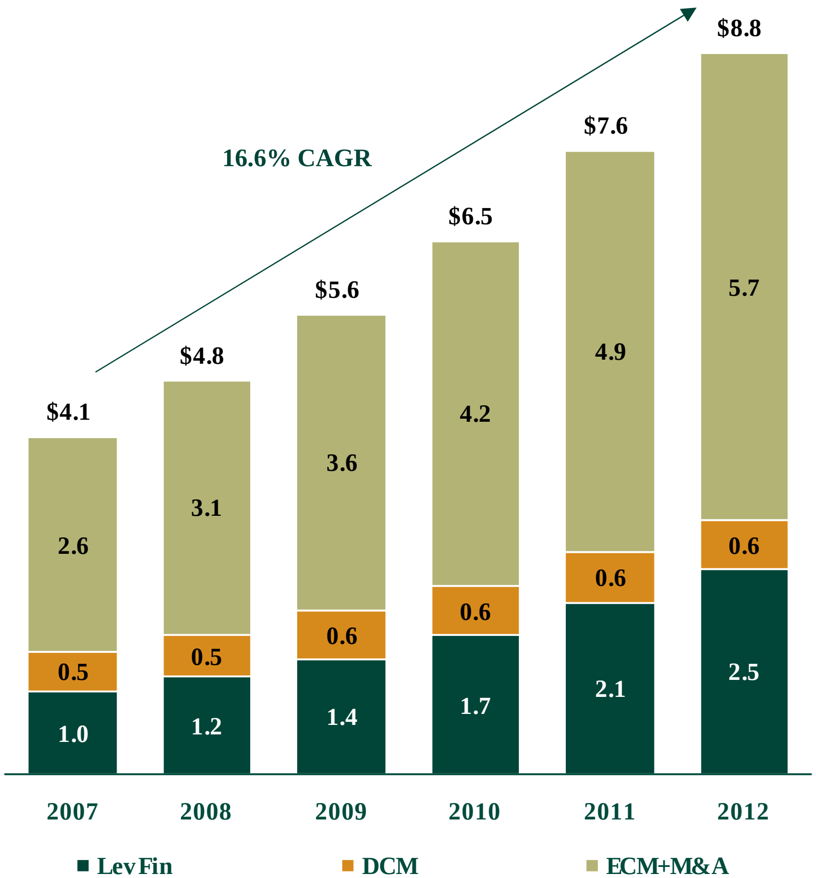
**To be revised**

*$ in billions*

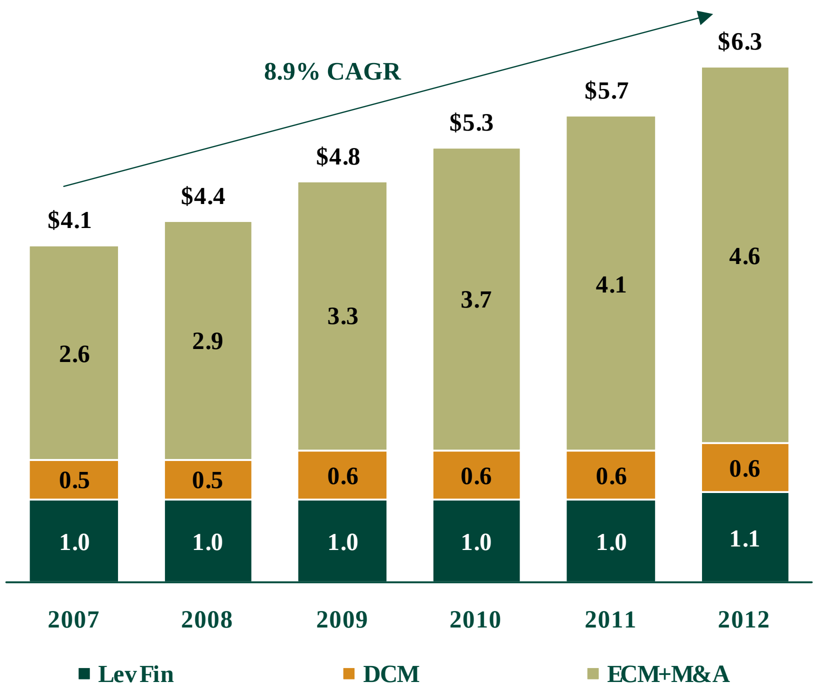
| Scenario 1 – Drive Revenue Growth | Scenario 2 – Capital Management |
|---|---|

- Investment Banking meets 16.6% growth target

***To be revised – 2010 target for IBD is no longer $6.5B***




- Investment Banking falls short of 16.6% growth target, achieving 8.9% growth



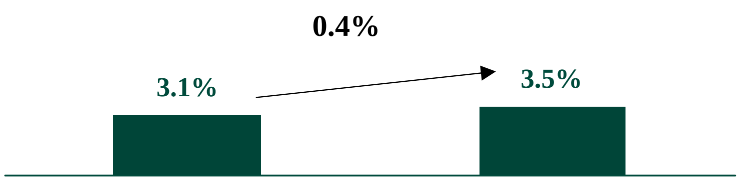
# Appendix

# Significant Improvement in Lehman Brothers' Share

## Gained share in Leveraged Finance and achieved top 5 in Financial Sponsors overall

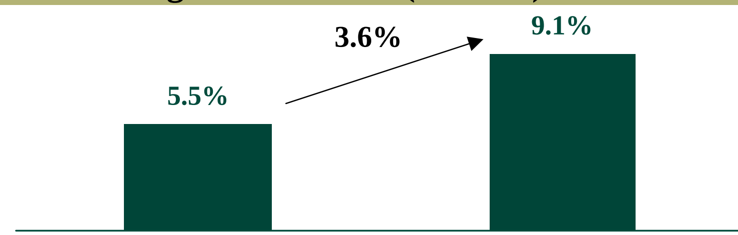
### Lehman's Global Leveraged Finance Share

#### Leveraged Loans (Volume)




| | 2006 | 2007* | Δ |
|---|---|---|---|
| Rank | 11 | 8 | 3 |
| Volume | $37.8B | $58.7B | 56% |

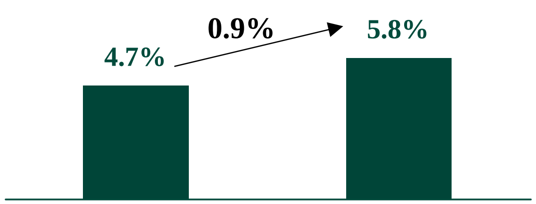
#### High Yield Bonds (Volume)




| | 2006 | 2007* | Δ |
|---|---|---|---|
| Rank | 9 | 5 | 4 |
| Volume | $9.7B | $11.0B | 14% |

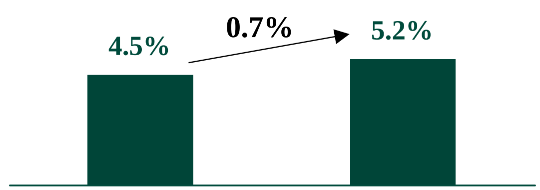
### Lehman's Global Financial Sponsor Share

#### Overall (Fees)



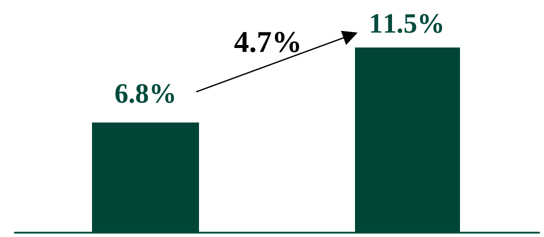

| | 2006 | 2007* | Δ |
|---|---|---|---|
| Rank | 7 | 5 | 2 |
| Fees | $847M | $959M | 13% |

#### Leveraged Loans (Volume)




| | 2006 | 2007* | Δ |
|---|---|---|---|
| Rank | 11 | 7 | 4 |
| Vol. | $22.5B | $35.9B | 60% |

#### High Yield Bonds (Volume)

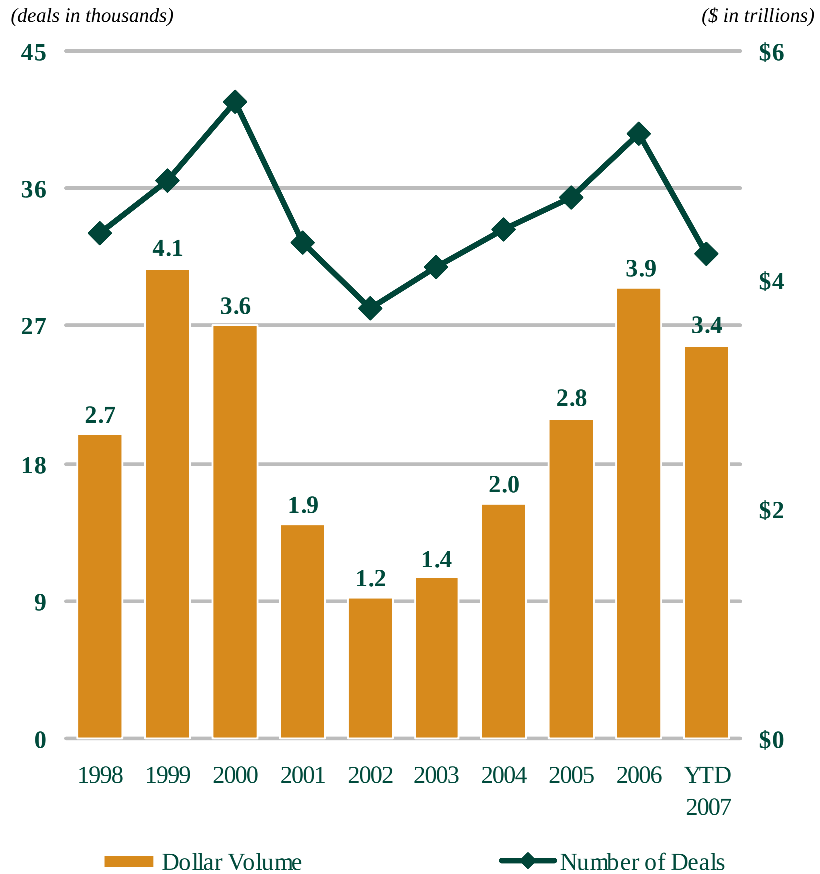



| | 2006 | 2007* | Δ |
|---|---|---|---|
| Rank | 6 | 1 | 5 |
| Vol. | $4.5B | $6.5 | 45% |

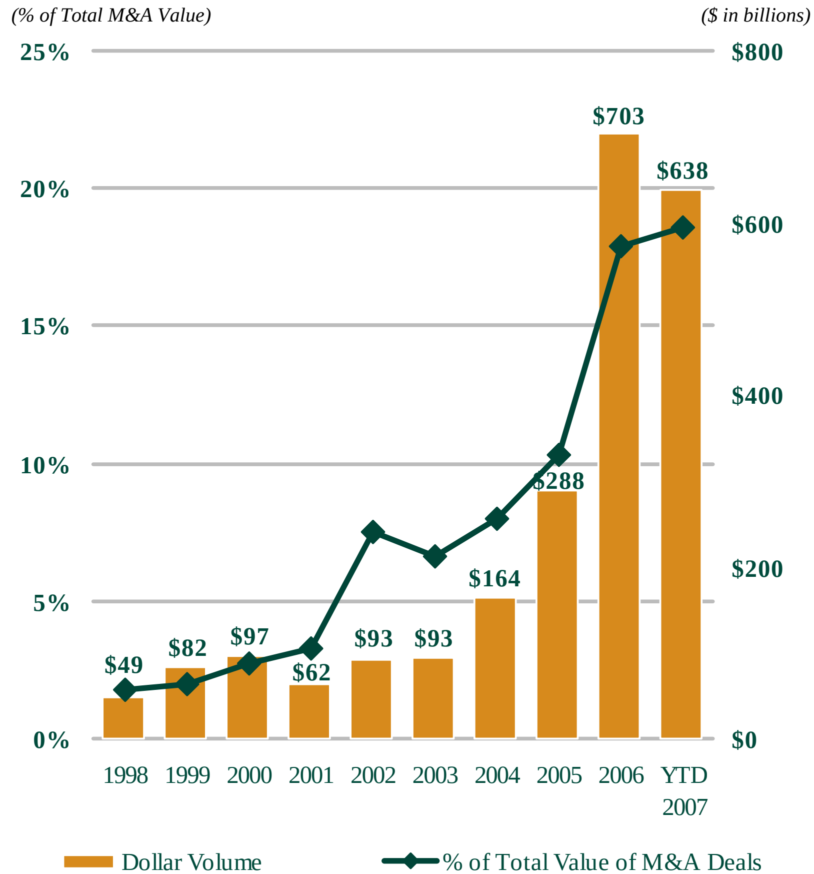
** 2007 data for Leveraged Loans and HY Bonds through September 25th. Overall Sponsor fee data through September 28th. Volumes and fees are annualized through 2007.*

# Market Update – Corporate Acquisitions and Sponsor LBOs

**1998-YTD 2007 Global Announced M&A Activity**




**1998-YTD 2007 Global Sponsor M&A Activity**




*Source: SDC Database, YTD 2007 through 9/26/07.*

# Market Update – Corporate Acquisitions and Sponsor LBOs

**Largest Announced U.S. LBOs ≥ $4B – LTM ($B) (1)**

| Ann. Date | Company | Sponsor(s) | Enterprise Value | EV/ LTM EBITDA | PF Debt | PF Debt / LTM EBITDA |
|---|---|---|---|---|---|---|
| 6/30/07 | BCE | Madison Dearborn, Providence, Teachers' Private Capital | $48.9 | 7.0x | $32.0 | 4.6x |
| 2/26/07 | TXU | KKR, TPG, GS | 43.8 | 7.9x | 39.0 | 7.0x |
| 11/19/06 | Equity Office Properties Trust | Blackstone | 35.0 | 18.5x | 29.6 | 15.7x |
| 4/2/07 | First Data[2] | KKR | 27.9 | 10.1x | 22.4 | 8.1x |
| 10/2/06 | Harrah's Entertainment | Apollo, TPG | 27.2 | 11.2x | 20.3 | 8.3x |
| 5/20/07 | Alltel | TPG, GS | 27.1 | 9.6x | 23.2 | 8.5x |
| 11/16/06 | Clear Channel Communications | Bain Capital, TH Lee | 27.0 | 12.1x | 21.5 | 9.6x |
| 7/3/07 | Hilton Hotels | Blackstone | 26.4 | 15.2x | 21.0 | 12.1x |
| 4/16/07 | SLM | JC Flowers, Friedman Fleischer & Lowe | 25.6 | NA | NA | NA |
| 5/29/07 | Archstone-Smith | Lehman Bros Real Estate, Tishman Speyer | 21.3 | 26.4x | 17.2 | 21.3x |
| 10/8/06 | Cablevision | Dolan Family Group | 20.8 | 11.3x | 15.5 | 8.4x |
| 9/15/06 | Freescale Semiconductor | AIG, Blackstone, Carlyle, Permira , TPG | 17.0 | 9.3x | 9.5 | 5.2x |
| 4/2/07 | Tribune | Existing Management (ESOP), Sam Zell | 13.4 | 9.5x | 9.5 | 6.7x |
| 12/18/06 | Biomet Inc. | Blackstone, GS, KKR, TPG | 10.8 | 14.5x | 6.2 | 8.3x |
| 6/19/07 | Home Depot Supply | Bain, CD&R, Carlyle | 10.3 | 10.4x | 8.6 | 8.7x |
| 2/4/07 | Mills Corp | Simon Property Group, Farallon Capital Mgmt | 9.2 | NA | NA | NA |
| 12/2/06 | Station Casinos Inc. | Colony Capital | 8.8 | 18.4x | 6.2 | 12.9x |
| 6/15/07 | Penn National Gaming | Centerbridge, Fortress | 8.7 | 13.8x | NA | NA |
| 3/20/07 | Affiliated Computer Services | Cerberus | 8.6 | 14.0x | 6.6 | 10.6x |
| 6/4/07 | Avaya | Silver Lake, TPG | 8.2 | 12.1x | NA | NA |
| 12/15/06 | Realogy Corporation | Apollo | 7.9 | 8.5x | 6.5 | 7.1x |
| 5/11/07 | Thomson Learning[3] | Apax, OMERS Capital Partners | 7.8 | NA | 5.4 | NA |
| 5/17/07 | Alliance Data Systems[2] | Blackstone | 7.7 | 11.2x | 6.1 | 8.8x |
| 5/14/07 | Chrysler[3] | Cerberus | 7.4 | NA | NA | NA |
| 3/12/07 | Dollar General | KKR | 7.3 | 13.0x | 5.0 | 8.8x |
| 7/23/07 | United Rentals | Cerberus | 7.2 | 6.0x | 5.6 | 4.7x |
| 5/2/07 | US Foodservice[3] | CD&R, KKR | 7.1 | NA | 3.7 | NA |
| 12/22/06 | Holiday Retirement (N. American Ops)[3] | Fortress | 6.8 | NA | 4.8 | NA |
| 5/29/07 | CDW | Madison Dearborn Partners | 6.5 | 13.1x | 4.6 | 9.3x |
| 7/2/07 | Manor Care | Carlyle Group | 6.0 | 12.4x | NA | NA |
| 6/28/07 | Allison Transmission | Onex, Carlyle Group | 5.6 | NA | 4.2 | NA |
| 5/11/07 | Pegasus Aviation Finance[3] | Terra Firma Capital Partners | 5.2 | NA | NA | NA |
| 3/19/07 | ServiceMaster | CD&R | 5.2 | 11.8x | 4.5 | 10.2x |
| 5/30/07 | Ceridian | Fidelity National, TH Lee | 5.0 | 13.7x | 3.7 | 10.1x |
| 3/14/07 | Beacon Capital Partners III[3] | Broadway Real Estate Partners | 5.0 | NA | NA | NA |
| 12/12/06 | Sabre Holdings Corp. | Silver Lake, TPG | 5.0 | 12.1x | 3.1 | 7.5x |
| 5/16/07 | Bausch & Lomb | Warburg Pincus | 4.5 | 17.5x | NA | NA |
| **TOTAL** | | | **$533.1** | | **$345.3** | |

*Source: Bank books, offering memoranda, proxy statements, SDC, CapitalIQ, Dealogic, Merger Market.*
*Note: Shaded deals denote Lehman Brothers involvement.*

*1. LTM represents deals between 9/26/06 and 9/26/07.*
*2. Represents a Lehman Brothers deal which contains information that is not publicly available.*
*3. EBITDA is not publicly disclosed because company is privately-held or a division within a larger company.*

# Competitor Comparison – HY Contingent Acquisition Facilities

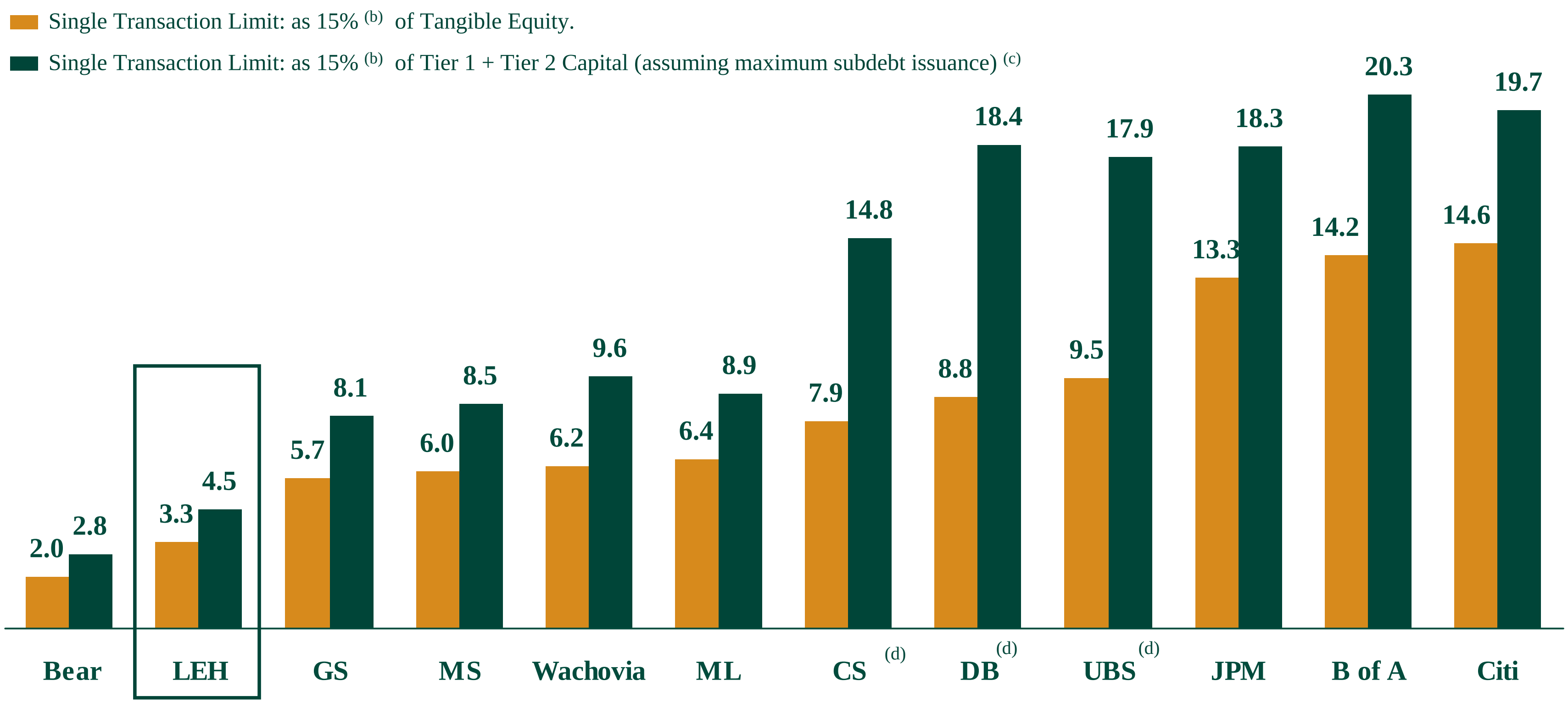
| | | LEH | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Actual | Adj. (1) | MS | GS | BS | DB(2) | Citi | UBS |
| Contingent Acquisition Facility Exposure ($B) | Q2 Contingent Acquisition Facility | 43.9 | | 42.8 | 51.0 | 20.8 | | 69.0 | |
| | Closed deals | 9.7 | | 3.9 | | | | | |
| | Withdrawn / lost deals | 2.1 | | 10.9 | | | | | |
| | Paired down | 9.3 | | 7.1 | | | | | |
| | 3rd party buyer / LLF | 6.1 | | 0.0 | | | | | |
| | Closed / dead / etc. | | | | 28.0 | | | | |
| | New Q3 commitments | 10.3 | | 10.1 | 19.0 | N/S | | | |
| | **Q3 CAF** | **27.0** | **21.6** | **31.0** | **42.0** | **7.6** | **41.0** | **57.0** | **13.0** |
| | Funded CAF at August 31 | 7.6 | 7.6 | n.a. | 10.0 | 2.0 | n.a. | | |
| | **Total Acquisition Financing Commitments** | **34.6** | **29.2** | **31.0** | **52.0** | **9.6** | **41.0** | | |
| P&L Impact ($M) | **Q3 P&L Impact** | | | | | | | | |
| | **Gross write-down** | **(1,294)** | **(1,294)** | **(1,200)** | **(2,400)** | | | | |
| | Fees, carry | 504 | 504 | 474 | 690 | | | | |
| | Hedges | 87 | 87 | – | 230 | | | | |
| | **Net write-down on CAF** | **(703)** | **(703)** | **(726)** | **(1,480)** | **(250)** | **(884)** | **(1,400)** | |
| Comparison | Gross-write-down as a % of Total Acq Fin Cmtmt | 3.7% | 4.4% | 3.9% | 4.6% | n.a. | n.a. | | |
| | Net-write-down as a % of Total Acq Fin Cmtmt | 2.0% | 2.4% | 2.3% | 2.8% | 2.6% | 2.2% | | |
| | Gross-write-down as a % of CAF | 4.8% | 6.0% | 3.9% | 5.7% | n.a. | n.a. | n.a. | |
| | Net-write-down as a % of CAF | 2.6% | 3.3% | 2.3% | 3.5% | 3.3% | 2.2% | 2.5% | |

*Note: N/S = Not Significant.*
1. *Adjusted for Archstone commitment ($5.4B), which was marked at par.*
2. *As of September 4th, disclosed as part of their recent debt issuance.*

# Competitor Comparison – Nominal Commitment Limit

**Nominal Commitment Limit: Competitor Comparison 2Q 2007 [(a)]**

*$ in billions*

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(a) *Tier 1 and 2 data for competitors not disclosed; estimate from GAAP data and recent subordinated issuances. Competitor tangible equity is estimated as Tier 1 Capital + Deferred Tax Assets.*
(b) *Difference between Tang. Eq. and Tier 1 Capital is primarily due to deferred tax assets > 1 year. Tier 1 Capital does not include deferred tax assets, however, Tangible Equity does.*
(c) *SEC allows qualifying LT debt to be included in Tier 2 capital for 3 years (through YE '08). This allows securities firms to gradually replace LT debt with subdebt without causing market disruptions. LEH currently includes the maximum LTD allowed (50% of Tier 1). For competitors, Tier 2 capital assumes maximum subordinated debt issuance - 50% of Tier 1.*
(d) *U.S. banking rules allow a maximum limit of 15% for single name exposure. European banking rules allow a maximum limit of 25% for single name exposure, and that limit may be exceeded without immediate notification to the regulatory body as long as the excess over the limit is covered completely by freely eligible equity resources. The 25% limit has been applied to CS, DB and UBS.*
(e) *All competitors currently displaying 2Q data, except ML, CS, DB, and UBS – Q1 was the latest available data for these companies.*

# Competitor Comparison – Nominal Commitment Limit

**Nominal Commitment Limit: Competitor Comparison 2Q 2007 [(a)]**

*$ in billions*

| | Tangible Equity | Tier 1 + 2 Capital: w/ Max Subdebt [(b)] | Single Transaction Limit: % Limit [(c)] | Single Transaction Limit: % Tangible Equity | Single Transaction Limit: % Tier 1+2 Capital (w/Max Subdebt) |
|---|---|---|---|---|---|
| Bear | 13.5 | 18.5 | 15% | 2.0 | 2.8 |
| **LEH** | **21.9** | **30.0** | **15%** | **3.3** | **4.5** |
| GS | 38.0 | 54.1 | 15% | 5.7 | 8.1 |
| MS | 40.3 | 56.6 | 15% | 6.0 | 8.5 |
| Wachovia | 41.5 | 63.7 | 15% | 6.2 | 9.6 |
| ML | 42.5 | 59.0 | 15% | 6.4 | 8.9 |
| CS | 31.4 | 39.4 | 25% | 7.9 | 14.8 |
| DB | 35.0 | 49.0 | 25% | 8.8 | 18.4 |
| UBS | 38.0 | 47.8 | 25% | 9.5 | 17.9 |
| JPM | 88.4 | 122.3 | 15% | 13.3 | 18.3 |
| B of A | 95.0 | 135.1 | 15% | 14.2 | 20.3 |
| Citi | 97.1 | 131.3 | 15% | 14.6 | 19.7 |

*(a) Tier 1 and 2 data for competitors not disclosed; estimate from GAAP data and recent subordinated issuances. Competitor tangible equity is estimated as Tier 1 Capital + Deferred Tax Assets.*
*(b) Difference between Tang. Eq. and Tier 1 Capital is primarily due to deferred tax assets > 1 year. Tier 1 Capital does not include deferred tax assets, however, Tangible Equity does.*
*(c) SEC allows qualifying LT debt to be included in Tier 2 capital for 3 years (through YE '08). This allows securities firms to gradually replace LT debt with subdebt without causing market disruptions. LEH currently includes the maximum LTD allowed (50% of Tier 1). For competitors, Tier 2 capital assumes maximum subordinated debt issuance - 50% of Tier 1.*
*(d) U.S. banking rules allow a maximum limit of 15% for single name exposure. European banking rules allow a maximum limit of 25% for single name exposure, and that limit may be exceeded without immediate notification to the regulatory body as long as the excess over the limit is covered completely by freely eligible equity resources. The 25% limit has been applied to CS, DB and UBS.*

# Lehman Brothers Leveraged Finance Pipeline – Detail[1]

*$ in millions*

| Deal | Lehman Commit. | Unfunded Commitments Sep-07 | Oct-07 | Nov-07 | Dec-07 | Funding Timeline Sep-07 | Oct-07 | Nov-07 | Dec-07 | P&L Mark | UW | M&A | Net |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| TXU | $4,738 | $4,738 | $3,175 | $3,175 | $3,175 | $0 | $1,563 | $1,563 | $1,563 | ($270) | $60 | $20 | ($190) |
| Archstone-Smith (3) | 4,281 | 4,281 | 626 | 626 | 626 | 0 | 3,655 | 3,655 | 3,655 | 0 | 77 | 0 | 77 |
| Riverdeep/ Houghton-Mifflin | 2,398 | 2,398 | 2,398 | 2,398 | 2,398 | 0 | 0 | 0 | 0 | (39) | 47 | 12 | 20 |
| Applebee's/IHOP (2) | 2,139 | 2,139 | 2,139 | 100 | 100 | 0 | 0 | 2,039 | 2,039 | 0 | 50 | 0 | 50 |
| PHH Corp. (2) | 1,703 | 1,703 | 493 | 493 | 493 | 0 | 1,210 | 1,210 | 1,210 | (6) | 10 | 10 | 15 |
| CDW Corp. | 1,494 | 1,494 | 102 | 102 | 102 | 0 | 1,392 | 1,392 | 1,392 | (89) | 33 | 15 | (41) |
| Alliance Data | 1,322 | 1,322 | 1,322 | 100 | 100 | 0 | 0 | 1,222 | 1,222 | (101) | 25 | 16 | (60) |
| Harman International | 1,146 | 1,146 | 1,146 | 1,146 | 1,146 | 0 | 0 | 0 | 0 | (119) | 21 | 4 | (94) |
| United Rentals | 975 | 975 | 975 | 143 | 143 | 0 | 0 | 833 | 833 | (26) | 20 | 0 | (6) |
| FairPoint Comm. | 832 | 832 | 832 | 832 | 832 | 0 | 0 | 0 | 0 | (30) | 10 | 10 | (9) |
| Sequa Corp | 820 | 820 | 820 | 60 | 60 | 0 | 0 | 760 | 760 | (29) | 16 | 4 | (9) |
| ACTS (Air Canada) | 724 | 50 | 50 | 50 | 50 | 674 | 674 | 674 | 674 | (24) | 13 | 1 | (10) |
| TRW Auto (4) | 650 | 650 | 650 | 50 | 50 | 0 | 0 | 600 | 600 | -- | -- | -- | -- |
| Endemol (Edam Acquisition) | 586 | 193 | 193 | 193 | 193 | 393 | 393 | 393 | 393 | (18) | 7 | 11 | (1) |
| McJunkin Corp. | 578 | 578 | 578 | 76 | 76 | 0 | 0 | 502 | 502 | (10) | 9 | 0 | (1) |
| LKQ Corp. | 545 | 545 | 50 | 50 | 50 | 0 | 495 | 495 | 495 | (32) | 7 | 0 | (25) |
| PHS Group | 545 | 72 | 72 | 72 | 72 | 473 | 473 | 473 | 473 | (16) | 8 | 0 | (8) |
| Hawaiian Telecom Yellow Pages (2) | 455 | 455 | 455 | 5 | 5 | 0 | 0 | 450 | 450 | (3) | 7 | 4 | 9 |
| Lloyds TSB | 453 | 0 | 0 | 0 | 0 | 453 | 453 | 453 | 453 | (17) | 11 | 0 | (6) |
| Metavante Corp. | 400 | 400 | 50 | 50 | 50 | 0 | 350 | 350 | 350 | (14) | 5 | 0 | (9) |
| ARINC Inc. | 365 | 365 | 38 | 38 | 38 | 0 | 328 | 328 | 328 | (18) | 7 | 0 | (11) |
| Debitel Group | 299 | 35 | 35 | 35 | 35 | 264 | 264 | 264 | 264 | (7) | 4 | 0 | (3) |
| Chevron Global (Delek) | 283 | 51 | 51 | 51 | 51 | 232 | 232 | 232 | 232 | (11) | 10 | 0 | (1) |
| Icopal A/S | 279 | 33 | 33 | 33 | 33 | 245 | 245 | 245 | 245 | (9) | 7 | 0 | (2) |
| Territory Res. / Consol. Minerals | 277 | 277 | 0 | 0 | 0 | 0 | 277 | 277 | 277 | 0 | 4 | 0 | 4 |
| Varel Holdings | 230 | 230 | 15 | 15 | 15 | 0 | 215 | 215 | 215 | 0 | 2 | 0 | 2 |
| Sisal SpA | 208 | 19 | 19 | 19 | 19 | 189 | 189 | 189 | 189 | 0 | 0 | 0 | 0 |
| Plains Exploration & Production *(FRL)* | 207 | 207 | 207 | 100 | 100 | 0 | 0 | 107 | 107 | -- | -- | -- | -- |
| Regent Seven Seas Cruises | 200 | 200 | 200 | 200 | 0 | 0 | 0 | 0 | 200 | 0 | -- | -- | -- |
| Merlin Entertainment | 195 | 23 | 23 | 23 | 23 | 172 | 172 | 172 | 172 | (3) | 5 | 0 | 2 |
| PQ Corp. (CPQ Holdings) | 145 | 145 | 145 | 0 | 0 | 0 | 0 | 145 | 145 | (8) | -- | -- | -- |
| El Paso Corp. / El Paso Pipeline Partners *(FRL)* | 125 | 125 | 73 | 73 | 73 | 0 | 53 | 53 | 53 | 0 | -- | -- | -- |
| A&P | 118 | 118 | 118 | 0 | 0 | 0 | 0 | 118 | 118 | 0 | 3 | 0 | 3 |
| Tenaska (TPF II LC) | 90 | 90 | 0 | 0 | 0 | 0 | 90 | 90 | 90 | 0 | 3 | 4 | 7 |
| Chronic Care Solutions (CCS Medical) *(FRL)* | 86 | 86 | 86 | 86 | 86 | 0 | 0 | 0 | 0 | 0 | -- | -- | -- |
| American Standard | 75 | 75 | 75 | 75 | 75 | 0 | 0 | 0 | 0 | -- | -- | -- | -- |
| Windstream Regatta | 59 | 59 | 4 | 4 | 4 | 0 | 55 | 55 | 55 | (3) | 2 | 0 | (2) |
| Tribune Co. | 52 | 52 | 52 | 20 | 20 | 0 | 0 | 32 | 32 | -- | -- | -- | -- |
| Regency Gas Services *(FRL)* | 35 | 35 | 35 | 35 | 35 | 0 | 0 | 0 | 0 | -- | -- | -- | -- |
| Pregis Corp. | 20 | 20 | 0 | 0 | 0 | 0 | 20 | 20 | 20 | -- | -- | -- | -- |
| Avago Technologies Finance Pte. *(FRL)* | 15 | 15 | 15 | 15 | 15 | 0 | 0 | 0 | 0 | -- | -- | -- | -- |
| **Total HY** | **$30,145** | **$26,346** | **$16,921** | **$10,115** | **$9,915** | **$3,095** | **$12,797** | **$19,604** | **$19,804** | **($893)** | **$482** | **$111** | **($301)** |

*Pipeline as of September 25, 2007.*

- *Excludes fronting for agented deals.*

(2) *Risk shared with Structured Finance.*

(3) *Real Estate deal. Funding is based on a hold of $1.175 bn and 100% funding.*

4) *Not yet mandated.*

5) *$333 mm bank commitment guaranteed by Home Depot, Inc.*

# Key Updates on Sun Valley 2006 Recommendations for Financial Sponsors Franchise

**Objectives: Maintain Top 5 Market Position with Sponsors and Increase Revenue Share in Corp. Acquisition Finance**

| Issue | Recommendation | Update |
|---|---|---|
| **Lending Capacity** | Organic Lending Capacity | ◆ Issued $3.7B of Tier 2 capital; and with retained earnings increased nominal commitment limit from $3.5B to $4.5B<br>◆ Educated Rating Agencies on nature of acquisition finance commitments to focus on amount at time of mandated commitment, not at time of commitment letter |
| | Lending Partnerships or Structured Vehicles | ◆ Deepened relationships with silent partners: Sumitomo, Commerzbank, also developing relationships with GECC and RBC<br>◆ Developed structured vehicle and initiated conversations with potential partners. However Moody's rejected methodology<br>◆ Formed Hudson Castle funding vehicle in 3/07 with $4B of capacity, upsized to $6B in 6/07, upsized capacity to $7.5B in 7/07<br>– Since inception, used vehicle for 5 credits, including TXU and several High Grade credits (IBM, Alcoa, Imperial Tobacco, Global Santa Fe)<br>– Currently using $6.1B of capacity<br>– Does not transfer risk, it only provides funding relief and increases the amount the Firm can lend in any transaction |
| **Becoming More Aggressive on Terms** | Create a Sponsor FRL Reserve Budget | ◆ Maintained credit standards, but participated in certain transactions with potential syndication losses, e.g.,<br>– Claire's, Dollar General, Harmon, Home Depot Supply |
| | Raise Private High Yield / Mezz Fund | ◆ In fundraising for $3.0B Global Mezz Partners Fund led by Mike Guarnieri<br>◆ Investments being warehoused |
| **Proprietary Ideas and Relationships** | Co-Invest with Sponsors on Select Transactions | ◆ Co-invested $2.2B alongside our clients in the last 12 months<br>◆ Notable transactions: TXU ($400M), BAWAG ($270M) First Data ($250M), Chrysler ($230M), Freescale ($143M), Tokyo Star ($125M), GMAC ($100M), CDW ($50M), Firth Rixson ($16M) |
| | Build out Whole Business Securitization | ◆ Key mandates: Dunkin' Donuts, Wendy's, Warner Music, Applebee's<br>◆ Team expanded |
| | Expand/Target Wealth Management Coverage of Sponsors' Partners | ◆ Initiated internal discussions, and had several meetings with Sponsors clients; however have made limited progress to date<br>◆ Plan to pursue in tandem with Middle Markets Sponsors effort this fall |
| | Expansion of Middle Market Sponsor Coverage | ◆ P.J. Moses to be appointed Head of Middle Markets Banking<br>◆ New Leveraged Finance and Financial Sponsors Middle Markets hires |
| | Expansion of Investment Banking Footprint | ◆ Hired 113 senior bankers (58 in 2006, 55 in 2007) for $250M in comp expense<br>– Total impact on revenue in excess of $250M |

# Funded Positions – End of 2Q 2007

## As of May 31, 2007, Lehman had $3.4B in Total Funded Positions Globally

*USD, Millions*

| Americas | |
|---|---|
| **Parent Name** | **Total** |
| Claire's Stores | $417.3 |
| Dresser | $387.1 |
| Bucyrus | $341.4 |
| West Corp | $88.5 |
| Pinnacle Foods | $46.5 |
| Iconix Brand | $42.3 |
| Edgen Murray | $24.8 |
| Bonten Media | $22.4 |
| Entegra | $13.4 |
| NSG Holdings | $5.6 |
| Verint | $4.3 |
| USPF Holdings | $2.0 |
| Oceania | $1.7 |
| Esteem Broadcasting | $1.4 |
| Brickman Group | $1.0 |
| Yankee Candle | $0.5 |
| Ports America | $0.3 |
| Audio Visual | $0.3 |
| Delek US Holdings | $0.2 |
| National Cinemedia | $0.2 |
| Waste Services | $0.0 |
| CBD Investor | $0.0 |
| Caribe Media | $0.0 |
| Synatech | $0.0 |
| General Nutrition Centers | $0.0 |
| Broadway Gen Funding | $0.0 |
| **Americas Total** | **$1,401.3** |

| Europe | |
|---|---|
| **Parent Name** | **Total** |
| Alpha | $594.8 |
| Merlin | $463.2 |
| Lavena | $371.9 |
| Sisal | $180.3 |
| Delphi | $161.7 |
| Neggio Holdings | $39.0 |
| Sacher Funding | $34.6 |
| Avio | $31.4 |
| Gala | $31.3 |
| Editis | $30.0 |
| Pages Juanes | $22.7 |
| First Chemical | $22.1 |
| YPSO | $14.6 |
| Liberator | $10.2 |
| Stahl | $4.4 |
| Heat | $0.3 |
| CWT | $0.0 |
| AVR Acquisitions | $0.0 |
| **Europe Total** | **$2,012.6** |