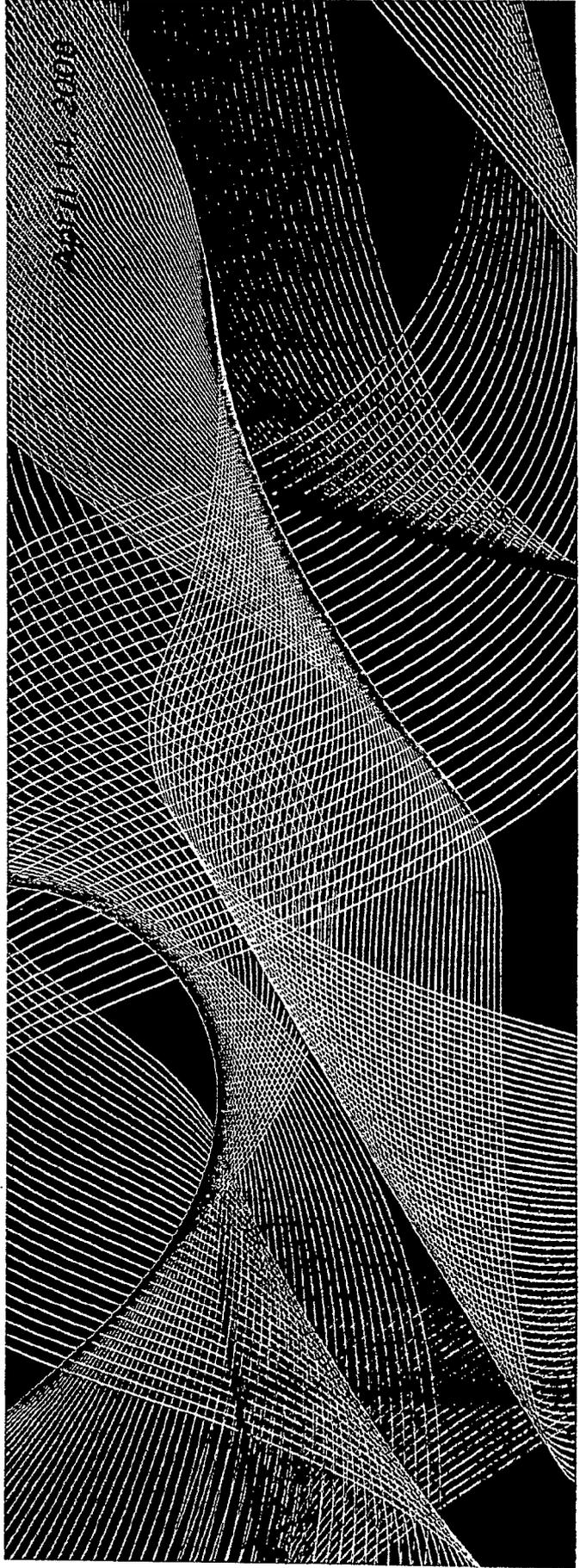


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LEHMAN BROTHERS

# Liquidity and Funding Review Special Topics



Confidential Presentation

LBEX-WGM 677800

# Topics To Be Discussed In Today's Meeting

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Agenda

- ◆ 2008 Preferred Issuances
- ◆ Freedom CLO
- ◆ 2008 Long-Term Capital Plan
- ◆ New Capital Allocation Methodology

# Lehman Brothers Tangible Equity

- ◆ Lehman Brothers has grown tangible equity by 91% since 2005 - partly as a result of preferred and other hybrid equity issuances.

## Tangible Equity \$ Millions, Percent

	2005	2006	2007	2008 Q1	2008 Q1 Proforma for Convert.	% Ch. 2005- 2008 Q1 PF
<b>Equity</b>						
Common	15,699	18,096	21,395	21,839	21,839	39%
Preferred	1,095	1,095	1,095	2,993	6,993	539%
Junior subordinated notes	2,026	2,738	4,977	4,976	4,976	146%
<b>Total</b>	<b>18,820</b>	<b>21,929</b>	<b>27,467</b>	<b>29,808</b>	<b>33,808</b>	<b>80%</b>
Less: Goodwill & intangibles	(3,256)	(3,362)	(4,127)	(4,112)	(4,112)	26%
<b>Tangible equity</b>	<b>15,564</b>	<b>18,567</b>	<b>23,340</b>	<b>25,696</b>	<b>29,696</b>	<b>91%</b>

## 2008 Non-Cumulative Preferred Stock Issuances

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The Firm has bolstered its equity capital with two separate Preferred Stock Issuances, raising nearly \$6bn year to date. Both of these transactions are part of the Firm's overall deleveraging strategy.

◆ \$1.9bn Non-Cumulative 7.9<sup>5</sup>% Preferred - February 2008

- Deeply Subordinate and included as Tier 1 Capital
- Callable at the issuer's discretion in 5yrs

◆ \$4.0bn Non-Cumulative Convertible Preferred - March 2008 (7 1/4<sup>8</sup>%)

- Deeply Subordinate and included as Tier 1 Capital
- Dividend can be deferred indefinitely
- Initial Conversion Rate 20.0509 per share, equivalent to \$49.87 strike per share
- More details next page

*Callable after  
5 yrs if stocks  
price is > 130%  
of conversion  
rate*

# Lehman Brothers' \$4 Billion Convertible Preferred Offering

April 1, 2008

## LEHMAN BROTHERS

**\$4,000,000,000**  
Non-Cumulative  
Perpetual Convertible Preferred

*Sole Manager*

LEHMAN BROTHERS

### Transaction Details

Non-Cumulative Perpetual Convertible Preferred Stock	
Offering Size:	\$4,000,000,000
Liquidation Preference:	\$1,000 (per Share of Preferred Stock)
Rating:	A3 / A- / A+ (Moody's / S&P / Fitch) <sup>(1)</sup>
Maturity:	Perpetual
Dividend Rate:	7.25% per annum on a non-cumulative basis
Conversion Premium:	32.50%
Mandatory Conversion Feature:	Non-convertible for 5 years, mandatorily convertible @ 130% of the then applicable conversion price at Lehman Brothers' option thereafter

*1. A credit worthiness of Lehman Brothers Holdings Inc. and is not a recommendation to buy, hold or sell securities, and it may be subject to revision or withdrawal at any time by the assigning rating organization. Each rating should be evaluated independently of any other rating.*

### Situation Overview

- ◆ On March 31, 2008, after the market close, Lehman Brothers announced a \$3.0 billion convertible preferred offering in order to:
  - Bolster capital, increase financial flexibility and accomplish our near-term strategy of reducing leverage
  - Optimize funding and accelerate our plan to reduce leverage and at the same time minimize dilution to shareholders
  - Take advantage of a "window of opportunity" in the market

### Transaction Highlights

- ◆ Lehman Brothers executed the transaction after receiving substantial reverse-inquiries from several key long-term clients and institutional investors
- ◆ The significant oversubscription of the offering demonstrated investors' confidence in Lehman Brothers
  - Coordinated efforts by Lehman's equity, convertible, and fixed income sales forces generated an oversubscribed order book soon after launch which allowed the transaction to be priced on an overnight basis
  - The transaction received significant interest from fundamental investors, and the offering was upsized to \$4.0 billion from the initial size of \$3.0 billion
  - The transaction is the largest overnight convertible preferred offering ever
- ◆ The securities priced with a dividend of 7.25% and a conversion premium of 32.5%, mid-points of the initial price talk range
- ◆ Lehman Brothers shares traded up 17.8% on the first trading day after the pricing of the convertible preferred

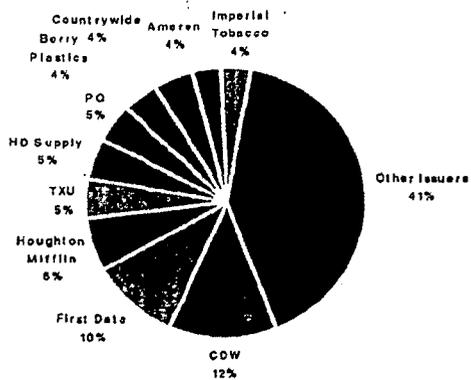
LEHMAN BROTHERS

# Freedom CLO

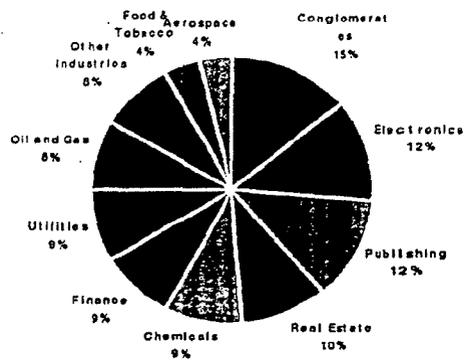
In March 2008, the Firm packaged 66 corporate loans into the Freedom CCS 2008-1, Ltd. Transaction raised \$2.8bn long-term secured financing

- ◆ The transaction's two tranches have a par value of \$2.8 billion divided into:
  - A Senior Note tranche of \$2.26bn rated A2/A (Moody's / S&P) that is eligible for the Fed Primary Dealer Credit Facility (PDCF)
  - Unrated Subordinated Note (equity) tranche of \$0.57bn
- ◆ The corporate loans were diversified by industry and issuer with the largest issuers, CDW and First Data, comprising 12% and 11% of the portfolio and all other names no more than 6%
- ◆ The coupon paid to the unrated Subordinated Notes is capped at 5% per annum until the Senior Notes receive all of their principal

**Portfolio by Issuer**



**By Industry**



# 2008 Long-term Capital Plan

- ◆ Aggressive deleveraging strategy will reduce cash capital usage by \$16bn this quarter
- ◆ Structured note issuance will largely offset other declines in CC sources and eliminate the need for any additional benchmark vanilla issuance for the balance of the year.

(\$Bn)	Q4 '07	Q1 '08	Q2 '08	Q3 '08	Q4 '08		
<b>Cash Capital uses</b>							
Fixed Income	93	103	97	97	97		
Equities	14	16	14	14	14		
Other	36	30	23	23	23		
<b>Total Uses</b>	<b>142</b>	<b>149</b>	<b>134</b>	<b>134</b>	<b>134</b>		
	<i>Change</i>	7	(16)	-	-		
<b>Cash Capital Sources</b>						<b>'08</b>	<b>'09</b>
CC Sources - BOP		150	156	149	148	<b>Total</b>	<b>Total</b>
LTD current portion		(8)	(8)	(4)	(5)	(25)	(16)
Extendibles		(1)	(1)	-	-	(1)	
LTD buybacks		(3)	(3)	(1)	(1)	(8)	
Bank facilities (net)		1	(2)	-	-	(1)	
Preferred		2	4			6	
LTD issuance							
Structured notes		6	3	3	3	15	
Vanilla - Senior		6				6	
Vanilla - Sub		2				2	
<b>Total Sources - EOP</b>	<b>150</b>	<b>156</b>	<b>149</b>	<b>148</b>	<b>144</b>		
	<i>Change</i>	6	(7)	(2)	(3)		
<b>Cash Capital Surplus</b>	<b>8</b>	<b>7</b>	<b>16</b>	<b>14</b>	<b>11</b>		

# Equity Adequacy Framework

Equity Adequacy Framework

Along with Risk Appetite, Risk Equity and Funding frameworks, the Equity Adequacy Framework is designed to protect the Firm against adverse events. It reflects the estimated amount of capital required to allow the Firm reorganize and restructure without resorting to bankruptcy in case of severe and prolonged crisis

## Multi-tiered Defense Structure

Severity and duration of adverse event	Line of defense / Components	Function / Protected stakeholders
Severe but limited duration	<b>Risk Appetite Framework</b> <ul style="list-style-type: none"> <li>• Earning power</li> <li>• Diversification</li> <li>• Flexible cost structure</li> </ul>	<ul style="list-style-type: none"> <li>• Ensures minimal acceptable level of earnings</li> <li>• Maintains the Firm's ability to recover while continuing to meet its obligations, including paying common dividends</li> </ul>
Severe and extended duration	<b>Risk Equity Framework</b> <ul style="list-style-type: none"> <li>• Common Equity</li> </ul>	<ul style="list-style-type: none"> <li>• Ensures the Firm's ability to meet all financial obligations in distressed environment without restructuring</li> </ul>
Severe but limited duration	<b>Funding Framework</b> <ul style="list-style-type: none"> <li>• Liquidity pool</li> <li>• Reliable funding</li> </ul>	<ul style="list-style-type: none"> <li>• Ensures the Firm's ability to meet all financial obligations without relying on asset sales for one year and with no access to debt markets</li> <li>• Protects secured and short-term unsecured lenders</li> </ul>
Severe and long-term	<b>Equity Adequacy Framework</b> <ul style="list-style-type: none"> <li>• Common equity</li> <li>• Hybrid equity</li> </ul>	<ul style="list-style-type: none"> <li>• Ensures the Firm's assets, even in case of liquidation following extended crisis, are sufficient to meet its obligations to counterparties and lenders</li> <li>• Protects long-term senior unsecured lenders</li> </ul>

## New 2008 Capital Allocation Methodology

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In 2008 the Firm is rolling out a two tiered charge for cash capital usage including both an equity usage charge for less liquid assets and a LTD effective rate charge for remainder of cash capital usage.

The Firm is also rolling out a new cash capital limit framework with penalty rates assessed for exceeding cash capital targeted usage at the business level.

### Summary of Changes

#### ◆ New Equity Allocation Charge for Less Liquid Assets

- Equity Adequacy Framework (EAF) is used to determine the amount of equity supporting Less Liquid Assets
- The EAF calculates the equity required to enable restructuring in crisis outside of bankruptcy without access to unsecured debt
- The 2008 charge will apply only to the Less Liquid Assets component of the EAF to create a greater focus on firm's liquidity in the current operating environment
- Businesses will be charged 500bps over the long-term debt rate for usage

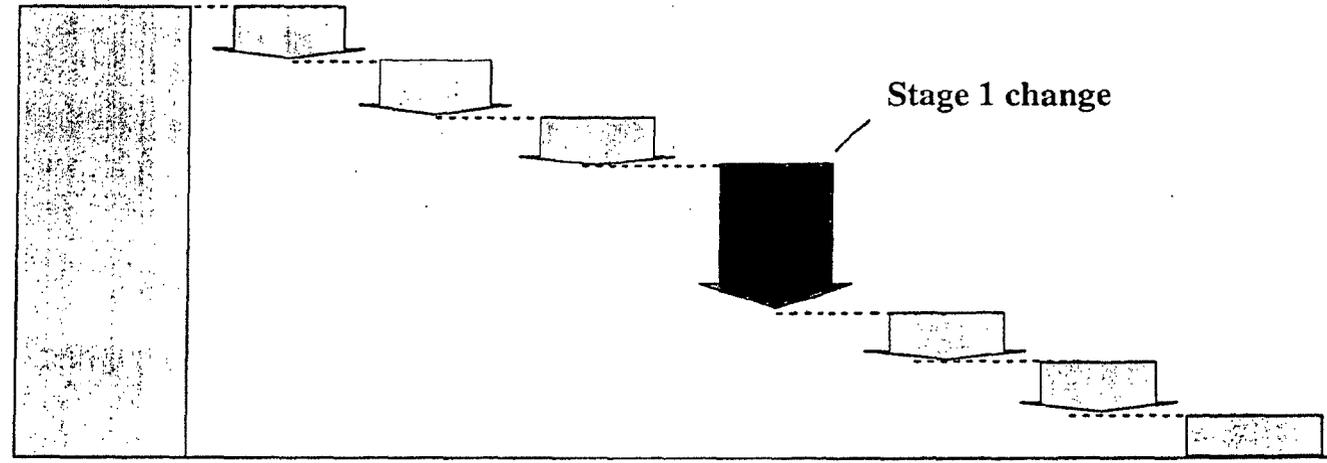
#### ◆ Cash Capital Limit Charge

- A new cash capital budget limit has been set for each business unit for each quarterly period of 2008 consistent with the Firm's deleveraging targets
- Business units will be charged a 2 year projected average cost of funds rate of 300bps over LIBOR, for any excess cash capital usage in excess of limits set.

# Equity Adequacy Framework

The equity allocation framework calculates the equity required to enable restructuring in crisis outside of bankruptcy without access to unsecured debt. The model incorporates both risk and liquidity considerations and can be applied at different levels of granularity: the Firm, divisions, businesses, and even trades

## Equity Compression in Crisis



Gross Equity Capital    Trading Counterparty Operational    Less-Liquid haircuts    FA impairment    GW impairment    Target Surplus

$$\underbrace{\left\{ \text{Common Equity} + \text{Hybrid Equity} \right\}}_{\text{Available Equity}} - \underbrace{\left\{ \text{Trading} + \text{Counterparty} + \text{Operational} + \text{Less-Liquid} + \text{Impairment} + \text{Target Surplus} \right\}}_{\text{Required Equity}} \geq 0$$

**Appendices**

# New Capital Allocation - Impact by Business

## Equity Charge & Limit Approach

Division	Current Budget at 45bps	Incremental Impact to 75bps	Elimination of Gross/Net Asset Charge	Equity Allocation @ 500bps	Total
FID	602	297	(157)	626	1,368
EQ	134	61	(42)	23	176
IBD	8	4	(2)	310	320
IMD	52	30	(7)	133	208
PIP	53	28	(11)	53	123
PS	97	26	(58)	102	167
CORP	0	2	-	-298	-296
<b>Total</b>	<b>945</b>	<b>447</b>	<b>(277)</b>	<b>949</b>	<b>2,064</b>

*mostly  
Real  
Estate*

*\$2.5MM per  
813 over  
per month*