

# FINAL TRANSCRIPT

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**LEH - Q1 2008 Lehman Brothers Holdings Inc. Earnings Conference Call**

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## PRESENTATION

**Operator**

Good morning and welcome to Lehman Brothers first quarter earnings conference call. All lines have been placed on a listen only mode until the question-and-answer session. (OPERATOR INSTRUCTIONS). Today's call is being recorded. If you have any objections you may disconnect at this time.

I would now like to turn the call over to Mr. Ed Grieb, Director of Investor Relations. Sir, you may begin.

**Ed Grieb - Lehman Brothers Holdings Inc. - Director of Investor Relations**

Thank you for joining us today for our first quarter update. Before we begin, let me point out that this presentation contains forward-looking statements.

These statements are not guarantees of future performance. They only represent the Firm's current expectations, estimates and projections regarding future events. The Firm's actual results and financial condition may differ, perhaps materially, from the anticipated results and financial condition in any such forward-looking statements. These forward-looking statements are inherently subject to significant business, economic, and competitive uncertainties and contingencies, many of which are difficult to predict and beyond our control.

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For more information concerning the risks and other factors that could affect the Firm's future results and financial condition, see risk factors and management's discussion and analysis of financial condition and results of operation in the firm's most recent annual report on Form 10-K as filed with the SEC.

This presentation contains certain non-GAAP financial measures. Information relating to these financial measures can be found under selected statistical information, reconciliation of average stockholder's equity to average tangible common stockholder's equity, and leverage and net leverage calculations in this morning's earnings press release, which has been posted on the Firm's website, [www.lehman.com](http://www.lehman.com), and filed with the SEC in a form 8-K, available at [www.sec.gov](http://www.sec.gov).

Now I'd like to turn the call over to our Chief Financial Officer, Erin Callan. Erin?

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**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

Thank you, Ed, and good morning, everybody. And I really want to thank you for joining us today to give our first quarter update and also the opportunity to give you a lot of information about the Lehman story that helps you be better prepared coming out of the call.

There's no question the last few days have seen unprecedented volatility, not only in our sector but across the whole marketplace. The acquisition of a major investment bank and the fed's newly created funding facility to the industry, the design to address dislocations in a secured lending market. Additionally, we have witnessed our own stock price decline by 31% over the past two trading days. We note it's up this morning but a very significant move.

So with that as a backdrop, I would like to use this morning's call as a real chance for us to take you through our performance, the strength of our liquidity and capital base, which I'm going to give you numbers through the close of business yesterday on liquidity, so everybody has that current, and the continued evolution and diversification of our franchise, which I think has told well through the performance this quarter.

So as you've seen in the morning's earnings release, and hopefully everyone has a copy of that, our results reflect the impact of what was a very difficult market environment and the resulting mark to market adjustments that came with asset repricing. But it was a story of two different natures in the quarter. And I'm going to discuss in some more detail later on, the mark to market adjustments materially impacted the quarter but otherwise we did see very strong client flows and a robust trading environment, which gives us a lot of confidence in the underlying enterprise of the business.

We saw a quarter where our risk management discipline allowed us to avoid any single outsize loss. And it's been our operating philosophy for a decade, which many people are very familiar with, that we remain closely focused on our liquidity, our long-term capital position, precisely for the purpose of weathering a difficult market environment that we've seen surfacing in recent weeks. So we're set up for that.

Further, we believe the fed's actions are a strong positive step toward stabilizing the capital markets and certainly enhancing liquidity for quality assets. I will come back to that in more detail later when I discuss our secured funding status.

So let me start with a very abbreviated review of the market environment during the quarter. And the reason it's abbreviated is just because we've seen such a dynamic shift in market conditions since quarter end, that I don't want to take too much time on this.

First, both equity and credit markets continued to decline throughout the quarter. We've seen significant issues continuing to weigh on the markets, including a whole host of factors, a substantial decline in liquidity, the ability to obtain leverage being challenged. Certainly fears and questions of a U.S. recession, the weak U.S. dollar, high commodity prices, and further evidence of weak residential mortgage data.

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On the fixed income side, we saw credit spreads in the U.S. hit multi-year wides, spreads in AAA, CMBS and ABS, widened out substantially, 180 basis points in AAA, CMBS, 140 in ABS in the quarter, reaching all-time wides. Mortgage-backed spreads, MBS spreads, reached their all-time wides. AAA, CMBX out by 135. ABX out by 275. And a similar story in investment grade and non-investment grade depth spreads. So investment grade out 50, and high yields/non-investment grade out 190.

The equity markets sold off, significantly impacted by weaker corporate earnings. Ongoing concerns about the consumer, and certainly a further slowdown in the housing market and housing price depreciation in the U.S. Equity markets were down overall with the MSCI world and the S & P down both approximately 10%, and most European and Asian indices we saw down similarly.

The good news however, was volatility and volumes remained at all-time levels, which actually provides a fantastic backdrop for the trading environment and for our own business model.

In Investment Banking, there was certainly weaker demand for fixed income securities with wider credit spreads, weaker equity valuations, and a general overall uneasiness around the globe, with respect to global economy which led to lower underwriting activity. With a decreased availability of credit, we saw sponsor activity decline substantially, and the volume of announced M&A declined 19% sequentially and about 24% year-over-year.

Also, M&A completed volumes were down 46% and 35% in the comparable periods. So overall very challenging backdrop on the Investment Banking side.

In the first quarter results, in this -- what we think and consider to be an extremely difficult environment, we posted net revenues of \$3.5 billion for the quarter. This is down 31% year-over-year and 20% from last quarter.

Net income was 489 million, down 57% year-over-year and 45% from the sequential period. As you saw this morning, diluted EPS was \$0.81, down 59% year-over-year, 47% over the sequential period. Our return on equity for the quarter was 8.6 and return on tangible equity was 10.6. I'm going to say that while our absolute performance is down considerably from comparable periods, what we did see this quarter were two competing forces at work.

A strong revenue run rate performance of the business, so \$5.3 billion run rate performance of our client franchise, which was partially offset by 1.8 billion of net mark to market adjustments, which I will discuss in some detail later in both gross and net terms.

With respect to our strong core client activity, the organization continued to be focused on key strategic objectives. Business diversification, we see our strong equity Capital Markets results in banking and Investment Management gains on revenues and market share, geographical diversification, non-U.S. revenues this quarter were 62% of the total. Customer flow activities generally remaining a primary revenue source. And we'll talk about how increases in client revenues helped drive the Capital Markets businesses. And very importantly, continued diligence around risk management, which includes the active involvement of our senior management team such that there was no single concentrated large loss.

We had disciplined liquidity and capital management, which we consider to be a core competency, and maintained robust liquidity to date, and we've executed close to two-thirds of our full-year capital plan at the end of the first quarter. And I will give you more details on that.

We demonstrated good expense discipline where non-personnel costs, excluding the costs associated with resizing the mortgage origination platform at Aurora, they were down slightly for the quarter. And we continue to reassess the scale of the organization since then.

However, to that point, our compensation ratio moved up slightly this quarter. This reflects the fact that we continue to selectively grow the franchise, look to the future of the organization, as well as being prepared to pay our people competitively and fairly.

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Now I would like to review each of the three business segments in its component parts. Starting with Investment Banking, we posted revenues of 867 million, which was actually up 2% year-over-year, and 4% from the end of last year. So despite the substantially slow down in industry volumes that I cited earlier, our corporate derivative revenues were very strong. Pretax income for the segment was \$182 million. Within the segment, we had a great story around M&A. Advisory revenues were 330 million for the quarter, which was up 34% year-over-year but down 15% from the sequential period.

We are excited to advise on several large completed transactions in the period that were really landmark deals, such as Imperial Tobacco, Chinalco, Rio Tinto, IBM Cognos, and MGI Pharma.

In addition, we have significant M&A advisory mandates in our pipeline, so in the first two months of the calendar year, we are ranked number two in global announced M&A with a 21% market share, and actually number one in the U.S. and Asia. We were also the advisor on three of the top five deals announced so far in 2008, so we're very proud of what we've done with that franchise.

In equity origination, our revenues were 215 million, up 23% year-over-year and up slightly from last quarter's level. For the quarter, our volume of equity origination totaled approximately 5.8 billion, up 23% from last quarter, down 12% a year ago. In the first two months of the calendar year, again, we're very excited to say that we were ranked number one in U.S. equity follow-on issuance, and we've been the book runner on six of the top ten U.S. follow-ons this year, as the IPO market has been quiet.

In addition, corporate equity derivative revenues contributed more modestly during the period but did contribute meaningfully in Europe.

Fixed income origination revenues were 322 million, down 25% year-over-year given market conditions as I discussed, but actually a pretty dramatic increase of 38% from last quarter's level. And the story for fixed income underwriting was a weakness in the high yield and structured debt markets that everyone is familiar with, offset by very, very strong high grade underwriting activity. On the high-grade front we were ranked number three in U.S. investment grade corporate issuance in the first two months of the year, with a 12% market share, so that's up significantly from 8% for calendar year '07.

We continue to have a strong underwriting position with financial institutions. We talked about that last quarter for both debt and equity. This quarter exemplified by our billion dollar follow-on offering for MBIA, \$3 billion convertible preferred for WaMu, 7 billion of preferred for Fannie Mae. And we expect this demand will broaden out due to other financial institution's capital needs, including the regional banks.

So despite everything I said about market conditions, we certainly saw good momentum in our Investment Banking franchise and the confidence of the clients in our expertise in that business.

While our volumes pipelines remain reasonably strong at quarter end, we do anticipate a smaller pipeline going forward as a result of current market conditions and being realistic about the protracted nature of the challenges we see in the market. Our volume pipeline is February 29, end of the quarter across all products was up 7%. With a fee backlog of 750 million, which was down 10% from November 30 levels.

Our M&A volume was 268 billion. Our equity origination pipeline was 29 billion, and debt origination was 40 billion.

Moving to our Capital Market segment, we posted revenues of 1.7 billion across debt and equities. That's down 52% year-over-year, 39% sequentially. Our Pretax income for the segment was 237 million. And as I noted earlier, despite the robust customer activity this quarter, our Capital Markets business did incur significant mark to market adjustments across numerous fixed income products, which was really consistent with broader market trends.

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And I'd like to take a moment because I think we get confused on this in terms of the parlance of the street but I'd like to take a moment to better define how we think about these adjustments and what they really mean. We look at the mark to market adjustments as more temporary in nature, as they reflect mark to market accounting related to the pricing of similar transactions in a liquidity constrained environment that we're living in and driven by many technical factors, which may not reflect intrinsic value.

And I'd really like to contrast that with write-off, which are more permanent in nature and refer to impairment. So I know there's been a lot of dialogue in recent weeks about the whole mark to market accounting mechanism, but I just wanted to highlight that this is under the mark to market accounting framework and not necessarily reflective of permanent impairment of the assets.

The gross revenue reduction, gross numbers for the quarter, from mark to market, prehedged, was approximately \$4.7 billion. And for those who want to follow along with the press release, page 13 lays out in very specific detail how we're going to speak to the gross and net write-downs for these asset classes. We did have 600 million of gains on our structured notes that offset the total gross write-down.

After hedges, we had a net impact of 1.8 billion, which I think is a pretty good testament to our hedging and risk mitigation capabilities that are core to our franchise.

So let me speak a moment about the composition of the net 1.8 write-down. Residential mortgage related positions accounted for 800 million, net. The 800 million net relates to 3 billion gross. So I think it's fair to say we continue to do a very, very good job managing the risk on residential mortgages, an area that I think we're credited with a lot of expertise, a great franchise.

Non-residential asset backed positions of an additional net 100 million. Commercial mortgages and related real estate up 1 billion. And 1 billion is net from 1.4 billion, reflecting the fact that it's much more difficult to hedge the commercial asset class. And I'll talk about the exposures a little bit later.

Acquisition related financings, which is generally thought of as the – either known as contingent acquisitions facility or leveraged loans facilities, of approximately 500 million net, that was 700 gross. So I think a good reflection again, of risk mitigation in that asset class. So in order to provide as much clarity and simplicity as we could, we did lay this out for you on page 13, and we're happy to take additional questions about it.

On the equity side of our business, we posted revenues of 1.4 billion, which is up 6% year-over-year, down 29% sequentially on the back of strong performance. During the quarter we had strong client revenues. We were up 3% over the near record sequential period in client revenues. So I would think a very good performance considering how strong last quarter was for the equity business. And that's 39% up over the prior year period.

We posted higher revenues in execution services, and somewhat offset by lower revenues in our volatility business versus benchmark periods. We continue to very actively grow our prime services revenues, our balances grew to 194 billion, which was an increase of 3% over last quarter.

And I think that's a notable fact because the industry's trend over the past quarter has been toward de-leveraging, weaker equity valuations, and thus shrinking balances on the whole. So to have increased 3% in that environment I think is a real statement to the franchise. We've actually added 60 clients in the PB business during this period and we increased revenues in every region. So we continue to see the byproduct in our equity business of the investments we've made on a client-focused franchise, and posted solid revenues on the back of client activity levels, despite what was a particularly challenging downward trending market.

Now let me turned to fixed income, the fixed income component of our capital market segment. We posted revenues of 262 million, which is significantly down from benchmark periods, and market dislocations and illiquidity generated substantial mark

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to market adjustments across a range of asset classes, which I just discussed a few minutes ago. Like our equity business though, our core client franchise performed exceptionally well with record client revenues up 40% and 55% versus sequential and prior year periods. And we track that through sales credits and that's an amazingly high increase in the customer flow business.

For the quarter we saw a number of our businesses achieve record revenue levels despite what was happening in price action in the markets. So if we look at the various asset classes underlying our franchise, we saw improved revenues in mortgage trading, so where mortgage originations slowed down to a halt, we made many profitable trading decisions where there was an environment for wide bid ask spreads.

Liquid markets had increased revenues, including interest rate products and foreign exchange, incredibly strong client activity, and high grade debt where we saw increased secondary trading on the back of a strong primary pipeline. And as we've spoken about several times in the past, we think the new -- with the new issue process definitely drives increased activity for us on the secondary side. It's very complimentary to the business.

Offsetting the above were the lower revenues resulting from market disruptions in other classes, such as munis and option rate securities. But on the whole, a very strong performance out of the underlying franchise in fixed income.

In Investment Management, we posted record revenues of 968 million, very happy about the performance of this franchise up 39% year-over-year, and a 16% increase versus last quarter. Our pretax income for the segment was 245 million. So for those who have followed us in this business, it's a stellar continued growth pattern.

The Asset Management component, we reported revenues of 618 million, up 49% year-over-year, 16% from last quarter. We saw increases in both traditional asset management as well as higher revenues from the minority investments we've made in alternative managers like D.E. Shaw, et cetera, that we've talked about in previous quarters.

We ended the quarter with assets under management of 277 billion, which is down slightly versus the year end, and that was really due to market depreciation. There were net inflows for the quarter. In Private Investment Management, which encompasses our high net worth client business, we realized revenues of 350 million, which is again, up 25% from a year ago and 17% from the quarter. We saw record revenues in that private client business of both fixed income and equities, and we ended the quarter with 553 high net worth brokers with average annualized production of 2.7 million. So incredibly productive group of people for the Firm.

As these results illustrate, our Investment Management segment continues to grow. It accounts for a larger proportion every quarter of our earnings, and it's a more stable source of revenues for the Firm.

Now let me briefly review our non-U.S. results, for the quarter, I mentioned a little earlier non-U.S. accounted for 62% of firm-wide revenues. There was about 2.2 billion of revs up 7% over the prior year. And down 20% from the sequential quarter, as we did see the mark to market adjustments affect the European performance and offset strength in part in Asia.

In Europe and the Middle East we posted revenues approximately 760 million, down 44% year-over-year, and 53% from the sequential period. Really accounted for in the mark to market adjustments because the Investment Banking revenues were higher for the period, primarily driven by M&A and the demand for corporate derivatives.

And the pipeline remains strong, Investment Management revenues were higher in the region, as we saw a record level of Private Investment Management revenues come through. And asset management revenues increased compared to the benchmark periods and we launched six new alternative funds in the region during the first quarter alone.

Our results in Europe as I mentioned, were impacted mostly by weaker results in Capital Markets as a result of mark to market adjustments that we saw move to Europe after they originated in the United States. And also to really compare apples to apples, the GLG gain we talked about last quarter was part of the European revenue base, so we've taken out that gain for the quarter.

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Of note, our client revenues were up 26% and 56% from sequential and year-ago periods, so again, same kind of story we're talking about around the globe. Great client franchise performance.

In equities, we became the first member firm to execute 5 million transactions on the LSC. Our European businesses continue to face the challenges as those in the U.S. We remain cautious, as we think it's prudent about the region, but despite the exceptionally strong trading environment that has emerged we think there will be ongoing volatility.

In Asia we posted record revenues of 1.3 billion, which is up versus both benchmark periods. Equity Capital markets higher than both periods of strength in principal, volatility, cash and prime services. Revenues on the cash side were mostly driven by activity in non-Japan Asia, particularly in India. Results in fixed income continue to be very strong in Asia on the back of interest rate, FX, and the credit businesses.

Investment Banking revenues in Asia were strong compared to both benchmark periods and we continue to gain market share and strength in the franchise. Very importantly, a landmark event for us ranking number one in both announced and completed M&A in the first two months of the calendar year, primarily resulting from the Chinalco transaction where we represented them in the purchase of Rio Tinto shares.

Talking about expenses for a moment, I referenced earlier, we increased our comp to revenue ratio this quarter to 52.5%. And this really reflects a few things. One, it's our intention to selectively invest in the franchise and look at it on a long-term basis, to pay our people competitively, and really to be direct and fair with our shareholder community about the challenges of the year, and trying to really come out with a number that we think is supportive of a full year without changing it late in the year.

Over the period our headcount declined slightly to 28,000. Since the end of the quarter, our headcount was further reduced by an additional 1,100. And we'll continue to monitor the sizing of our workforce versus the opportunity.

For the quarter, our non-personnel expenses totaled 1 billion, essentially flat to last quarter's level which I think is a pretty good accomplishment. We had lease termination and other asset write-offs associated with the mortgage origination business, which amounted to 34 million which was 18 million in the fourth quarter.

And even with higher variable costs in brokerage and clearance with all the volumes that we saw coming through, and the increased cost of occupancy, operating as a global business, we saw those offset by decreases in professional fees, business development, technology costs. So good expense discipline by the Firm as most people are familiar with in tough times.

Taking all this into account, we reported a pretax margin of 18.9% for the quarter. That's versus 28% for the sequential period. Our effective tax rate was 26.3, reflecting the larger pretax contribution from outside the U.S. So primarily non-U.S. revenues.

Now I want to make a few comments about the balance sheet. We started doing this last quarter, and trying to give the group a great amount of transparency on the balance sheet. Again, you can follow along on page 13 with some of the numbers we have there from the press release. And this is designed to give you a sense in comparison of where we were on November 30 and where we are today on some very important asset classes.

So the end of the quarter, we were up stockholders equity of 24.8 billion, up 10% from 2007 year end. Long-term capital rose to 153 billion. This includes the issuance of long-term debt of 19 billion. We did 1.9 billion in preferred stock in the quarter. And we took an opening charge to equity of 180 million related to adopting FIN 48, which is a new accounting pronouncement for tax contingencies.

The average tenor of our long-term debt has continued to extend and is seven years at this point. We do believe that long-term debt in general will be harder to obtain throughout 2008. We've had that strong point of view since late last year, and therefore we'll continue to prefund, as we have done so far this year, our liquidity needs as we see opportunities in the markets. And consistently with that, we've already completed two-thirds of our capital plan needs for 2008 as we come out of the first quarter.

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Over the course of the quarter, we repurchased 13 million shares at an average price of \$59 a share. We also announced our Board's approval for the continuation of our stock repurchase program for the management of the Firm's equity, including the consideration, as we have year-over-year, of the dilution from employee awards. And this authorization is broadly consistent with what we've done in prior years.

We've also increased our annual common stock dividend rate to \$0.68 per share, which translates to about \$50 million annually. Our book value per share was essentially flat, ticked up a bit at 39.45 per share, and really related the timing of share buybacks for the quarter.

We did, very deliberately, take leverage down for the quarter. We ended with a net leverage ratio of 15.4 times down from 16.1 at year end. And we will continue to allocate capital on the balance sheet in the market in a way that we consider prudent, and that reflects the liquidity profile of the balance sheet.

Although our average historical simulated value at risk increased slightly to 130 million from 124, I would note that our period end VAR was 106 million. So trending down as consistent with our view trending down on the risk profile of the balance sheet.

Next, I'd like to review our liquidity position in a different way than we typically do and give you a lot more information. And I'm going to give you information that takes you through the quarter end and actually takes you through end of day yesterday. And I think that, given the environment we're in, we've tried to add a lot more transparency here, as we've tried to relay the strengths and robustness of the liquidity position of the Firm.

As we've discussed in the past, we have structured our liquidity framework for a decade to cover expected cash outflows for the next 12 months. And we do so without being able to raise new cash in the unsecured markets, or without having to sell assets that are outside our liquidity pool, and the liquidity pool is comprised of basically cash and cash equivalents. The framework I'm describing was specifically designed after 1998 and our experiences then, for this type of environment, so I want to be clear about that.

It includes several important factors, which based on our prior experiences, make us feel that it's very relevant to what we're experiencing today. So let me just lay out some of those factors.

We have minimal reliance on commercial paper, short-term unsecured financing, or asset-backed commercial paper programs. We know that those forms of financing are not there for you in difficult markets. We have no reliance, and when I say no reliance, I mean we don't use it to fund our balance sheet on customer free credit balances.

We have no reliance, and when I say no reliance, I mean we don't use it to fund our balance sheet on customer free credit balances. We have no reliance on secured funding that's supported by whole loans or other esoteric collateral. We utilize our three regulated banking entities also to provide a distinguished and reliable funding source for certain mortgage and corporate loan assets.

So let me give you the quarter end numbers. At February 29, our holding company liquidity pool, which is invested in cash and cash equivalent assets, was 34 billion. As of the close of business yesterday, this amount was down to approximately 30 billion, which was primarily driven by the reduction in our outstanding commercial paper. So we just took commercial paper down by 4, and that was the offset.

This corresponds to cash capital surplus at the holding company of 7 billion at February 29 and approximately 5 billion as of close yesterday. This represents all the excess of our long-term funding sources over our long-term funding requirements. Both of these measures are well in excess of our targeted levels and in line with year end levels of 35 and 8, respectively.

In addition, a very important additional fact is the measures exclude unencumbered assets of 64 billion at the holding company. And in unencumbered assets, just so that everybody is on the same page here, are a pool of assets that have not been financed

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against, they're available to get financing, and we could tap into this pool to get additional cash at any time. So another 64 on top of the 30, bringing us close to approximately 100 billion of liquidity, plus an additional 99 billion at the regulated subsidiaries. Both those amounts of unencumbered assets are unchanged since quarter end.

Our banks at the end of the quarter had over 7 billion of excess liquidity to fund qualifying assets, with an additional 8 billion of capacity. Some of that, that comes through the home loan bank with respect to the Delaware thrift.

I want to talk about secured funding. The first thing I want to say about secured funding and repos is, net at the end of yesterday we had not lost any repo funding capability. So despite the fed funding facility, which I will talk about, I think it's critical to understand how our counter parties behaved in this arena. So at the end of the day yesterday, we still were net flat in terms of secured funding capability.

Total repo, exclusive of the match book, was 215 billion of which a substantial majority of this collateral is eligible to be pledged under the new fed facility. We have 115 billion of tri-party secured financing, which is really just the total repo amount less treasuries and agencies which go through the FICC system anonymously.

We have an average tenor of 24 days, and we have the ability to substitute non-treasury collateral into these facilities, where treasuries are currently in place just as an overfunding mechanism. So we have retained a lot of dry powder in our repo arrangements for non-treasury, non-agency assets. All these amounts are consistent with February 29 balances.

Our customer free credit balances are at 5 billion. As I mentioned earlier, we do not use those in any way to fund Firm assets. It's client cash. And this amount has come down since the end of the quarter of a -- just as a note, and we think reflective of the environment.

Obviously the fed's actions over the weekend were tremendously supportive and stabilizing by lowering the discount rate and more importantly, establishing the new collateralized lending facility for primary dealers. Although we have not yet used the facility, the rate and margin levels are very attractive. So we would expect that the dealer community will actively begin to access the new program.

Lastly, we successfully completed the renewal of our three-year syndicated unsecured bank facility this Friday, on substantially similar terms to our prior facility. I think there was a little bit of confusion about this on Friday in the markets. We just happened to close this on Friday, so the timing got a little integrated with the Bear Stearns news.

It's a \$2 billion unsecured facility that we've had in progress for several months. We ended up with 40 participating banks, substantially oversubscribed, a drawn cost of LIBOR plus 60, and so an incredibly good statement about the strength and confidence of our franchise.

Also, for those who saw it, Moody's reaffirmed our A1 credit rating yesterday, with some very good commentary about the strength of the capital base in the franchise and the liquidity.

So that's a fair amount of color I tried to give you about how we fund ourselves, why we feel comfortable with our liquidity, even absent the fed facility, would feel very comfortable. The fed facility is a great addition to the equation, and why we think we're in a good position in today's market. So wanted to make sure everybody was fully engaged and had all the information that they needed on that front. I will note that at least at the time that I got on this call this morning, our credit spreads, which have been closely watched by the community, had tightened by 110 basis points this morning, and we're about 320 over at that point. So seeing some good performance on the back of earnings.

Let me talk about exposures before I get to outlook. Here we can turn to page 13 and look at some of the key balance sheet items at the end of the quarter. For mortgages, the first asset class I want to talk about, our total balance sheet ended 85 billion

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down from 89 at 2007 year end. If we exclude the FAS 140 gross-up for amounts sold to third parties and accounted for as financings, the balance sheet decline to 74 billion from 77.

So let me break out the 74.32 billion of residential mortgages, 36 billion of commercial mortgages, 7 billion of non-resi asset-backed securities. Within resi, as you see, the number is only down slightly, which is not the whole story. We actually sold a fair amount of assets during the quarter and bought opportunistically some very attractive assets that we saw available on the market. So that doesn't reflect a static situation.

Subprime, which has been an intense focus which includes both whole loans and securities, now totals 4 billion versus 5.3 at year end. We continue to have significant hedging against that balance sheet exposure.

Whole loans were 1.3 of the 4 and the remaining amounts are primarily investment grade securities. 82% of which are AAA or AA, so very high quality.

Prime and alt-A make up 14.6 billion versus 12.7 at year end. Again reflecting a fair amount of assets sold and bought opportunistically, and also includes a meaningful component of servicing which we added during the quarter, which really does reflect a very natural hedge for the mortgage asset class.

European mortgages total 9.5 billion, so down slightly from 10.2 at year end. And then I want to give you a little bit of color on valuation because it comes up very often. How do we value these securities in this environment.

And for residential securities it was a pretty different story for this quarter than last. We began to see a lot more transparency in the alt-A sector late in the quarter, allowing us to mark positions based on observable prices, much less use of models.

People are familiar with the developments around the Pelican fund and really create a lot of market transparency. And this included loans as well as securities across the cap structure. In Europe there's a more liquid derivative market evolving, which is providing us a better basis to value those positions.

So let me turn to the commercial mortgage portfolio. 36 billion of commercial mortgages, 25 billion represents loans, 11 represents securities. Within the securities asset class, 85% are AA and AAA rated. Our whole loan portfolio is relatively well diversified, geographically there's 14 billion in the U.S., 5 in Europe, and 6 in Asia. And all these markets have performed somewhat differently.

88% of the loans are floating rates, and no single property type is greater than 25%. And in this case, office properties, which is the one -- the greatest concentration, tends to be located in the major metropolitan areas that provide the best value.

Again, questions on how we value the commercial portfolio, we look at a number of data points including activity in loans with similar property types and similar regions because there's a very regional element to this. We look at recent securitizations, we look at loan syndications, CMBS spreads and the CMBX index. And in fairness, as opposed to last quarter, we have seen similar spread experiences in recent securitizations as a CMBX, so what was a divergence in the last quarter has really converged to be pretty identical pricing as securitization and CMBX.

Delinquencies in commercial mortgages continue to be very low at approximately 40 basis points. Our research expectations that they would not exceed 70 in a difficult environment but however, I will note that our valuations reflect how the market is pricing these positions, not the fundamentals of the asset class, regardless of our view on their intrinsic value.

I do want to make one note not reflected on page 13 but I think it's an important fact. Since the end of the quarter, we've been actively reducing the balance sheet exposure in the commercial asset class, because we've seen a little bit more liquidity. You have a combination of close, sales and commitments from quarter end, so just in the past two weeks, which approximate 5

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billion, which would take our number down from 36 to 31. So I think good progress in terms of the overall balance sheet exposure at the right price in that asset class.

In acquisition finance, where prices declined about 4 to 5% during the quarter, I think with did a good job managing our unfunded future commitments.

I'm going to take you through both the high grade and the high yield side separately. So at quarter end we had investment grade acquisition related exposures of 10.9 billion versus 11.9 at year end. I want to just mention here that with the uptick in the amount of strategic M&A with companies who want to retain investment grade ratings post transaction, the investment grade acquisition facilities and volumes have increased and I think it's a statement about the strategic environment.

Contingent commitments for deals not yet closed were 7.2. This is in the context of high-grade. This is not a number we have talked about before. Unfunded commitments for closed deals of 800, and funded loans of 2.9. So we really wanted to lay out that side of the equation also in addition to the high yield side. So on the non-investment grade side we had a total of 17.8 at quarter end, compared to 23.9 of total exposures at year end.

So let me break this down again into numbers that people are familiar with. Contingent commitments, 3.7 billion. And this is down from close to 10 billion last quarter, those of you who remember, this was the number that was 27 at Q3 and 44 at Q2.

So just tremendous progress in bringing this number down more than 90%. Unfunded commitments for closed deals of 2.2 and funded loans of 11.9. So all in all, when I look at our total acquisition finance facilities, taking down from about 24 to 17, just great progress in continuing to move those backs at the right prices.

In terms of other exposures, our monoline exposure remains minimal, spread out over nine counter parties, represents the funded balance sheet position issued by monolines and any derivative exposures all included. In terms of derivative counter parties, exposure is approximately 94% continues to be investment grade as our counter party.

With respect to Artstone, want to mach a comment here, again in the interest of transparency ahead of questions, we currently hold 2.3 billion of the non-investment grade debt related to that transaction and 2.2 billion of equity, both currently carry materially below par. We're actively de-levering that company through asset dispositions at attractive levels, and improving the financial profile.

In terms of level 3 assets, we expect a slight increase for the quarter to 39 billion. This represents 5% of total assets.

So that's a rather detailed summary of our exposure. Wanted to give that you color. And wanted to give you some sense of why current dislocations in the markets did significantly impact us as we play in all these asset classes. So while mark to market volatility is significant, we believe a significant portion of this is related to the illiquidity.

Let me talk about outlook for a moment, which you've probably gotten the message so far, but looking forward, despite the positive developments of fed actions in the past few days and few weeks, we still don't anticipate the challenging market conditions abating any time soon and we have planned our business accordingly. As we look out to the remainder of the year, we certainly will remain vigilant around risk, capital, and liquidity. As we talked about last quarter, as a Firm we remain very cautious overall. But we continue to feel good about our competitive position.

For the quarter we moved from 4.4 to 5.5% Investment Banking market share. And we think our ability to gain share across the businesses is being reflected by the performance of the core franchise. We see our clients are active and our strategy to take up share is paying off.

Our Investment Management business continues to add mandates and show strength in revenue growth. There are, however, still obvious headwinds that are going to pose challenges to the economy, therefore the Capital Markets, therefore ourselves.

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Ongoing liquidity and asset repricing concerns continue. The alt-A pricing is down 10 points since the end of the quarter, the AVX down three, so we don't expect to migrate to any great stability in the near term.

The recent lending plan of the fed certainly will be a positive as that works its way through the market and is understood by participants but that will take its time. We see constrained bank balance sheets contributing to continued de-leveraging in the Capital Markets, making it challenging to sell at reasonable prices highly rated assets. High oil, grain, and other commodity prices are fueling inflation concerns in the U.S., damped down a little bit in the last few days, but certainly have an impact in the fed's ability, in terms of cutting rates to promote growth. And we see the spillover of the economic slowdown in the U.S. to global markets.

Our Lehman strategists expect U.S. growth to be minimal both in '08 and '09, and our outlook for global GDP growth is 2.3%. So pretty small number for 2008.

As I think I've been reflecting throughout the remarks this morning, we have modest expectations about the level of industry-wide Investment Banking activity. While announced M&A volumes will decline, we feel we're well positioned as I talked about, in terms of our number two ranking in announced M&A and our market share gains in the advisory business.

Strategic buyers also continue to be very active as we expected at the end of last quarter. 84% of M&A activity came from the strategic side. Given the globalization of markets and the relative standing of the dollar, we also expected cross-border M&A to pick up, which it did, accounting for 43% of announcements.

But while we continue to hear and see much dialogue around M&A, execution and finalizing transactions will be key and will be the focus in the volatile conditions that we see.

We also expect equity issuance to stay at low levels for the entire year. However, given the continued distress in the markets, one sector where we still expect to see a significant amount of capital issuance in the coming months is financial institutions, as they continue to increasingly address their balance sheet needs and raise capital, an area which we have done incredibly well in and feel well positioned going forward.

We expect fixed income origination to decline 6%, obviously coming from a lower amount of securitizations and M&A financing, but absolute rates have come down so substantially that high-grade borrowers who borrow on a fixed rate, non-LIBOR basis actually see very good opportunities in the marketplace.

Our increase in market share can be attributed to clients looking to our expertise in difficult conditions. That's been the case for a decade that we've been acknowledged for that capability. And then given the shape of the credit curve, we also see a continued term-out of commercial paper.

In equity markets, valuations remain attractive even after adjusting for higher risk premiums, which had increased market activity. And given what the markets have been through recently, we expect active risk mitigation strategies on the part of our clients, which will continue to be a good profit tool globally for institutional investors and for Investment Banking clients.

And though we expect fixed income capital markets will continue to face uncertainty with little visibility over the near term, the robust client activity I described in the remarks and liquid products as risk aversion has clearly prevailed in recent months, and there's been the beneficiary in those asset classes.

In general we expect customer activity to stay strong, significant portfolio reallocations as we saw this quarter in rebalancing. We also expect volatility, bid out-spreads to remain high which is great for our trading businesses. And in general, I think we continue to navigate the current downturn relatively well and feel competitively well positioned.

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We've benefited from the growth and diversity of our franchise, I think comes through in today's numbers, that have helped us offset a significant downturn in the fixed income markets. Big strides commodities, prime brokerage, rates, emerging markets, and as I talked about, the share in Investment Banking.

So let me conclude by noting that we don't expect that this extremely challenging period is going to end in the near term. However, we do believe we have the leadership, the experience, the risk management discipline, the capital strengths, and certainly the liquidity to ride out the cycle.

In addition we believe that the current markets will continue to present us with a lot of client and trading opportunities, which we look forward to, that come from market dislocations. And as we successfully meet these challenges, capture these opportunities, we certainly believe we're positioning ourselves well for the long term.

So I know that was a lengthy section of remarks for this morning. It was intended to answer what we expected to be a number of questions on some important items, so hopefully that was useful. And now I'm happy to turn it over to take some questions.

## QUESTIONS AND ANSWERS

### Operator

Thank you. (OPERATOR INSTRUCTIONS). Our first question today is from Meredith Whitney. You may ask your question and please state your company name.

### Meredith Whitney - Oppenheimer - Analyst

Hi, good morning, Oppenheimer. You did a great job, Erin. I really appreciate the disclosure, I'm sure everyone does. I have a really basic question which is, I appreciate the expanded credit facility by the fed and how much that helps out the broker dealers, but the issue of a permanent buyer still remains, the outstanding issue of this lack of permanent buyer for so many of these securities still remains. You, and we don't know yet what Goldman's leverage is yet but I imagine throughout the course of this week leverage levels will still be high.

So can you comment on what type of -- you're under no pressure to bring those down but what type of time horizon do you see that coming down and at what pace? And then my follow-up question is, I know you, the brokers, have your own internal risk weighted capital models but the event in February where over \$360 billion of securities were downgraded must have tripped some type of trigger in terms of regulatory capital requirements. Could you comment on that as well, please?

### Erin Callan - Lehman Brothers Holdings Inc. - CFO

Yes. Let me start with the first question. Good to talk to you, Meredith. The leverage question and the sale of assets, you're correct, I mean, for sure, with respect to the environment around asset liquidity. So are there less liquid available buyers today than there were six months ago, nine months ago? Yes. And as a result, you've seen the balance sheet move a bit, not in a substantial way, but in a way that reflects I said some very good and profitable trading activity.

We did have a deliberate decision this quarter to take leverage down, which I think is more appropriate for the increased illiquidity of the balance sheet, and if the environment continues to stay this way we'll continue to be focused on that discipline. The real balancing act that I'm sure you can appreciate, that we think hard about is the balancing act of our fundamental view of the assets themselves, what we consider to be the loss of P&L associated with selling an asset at a given price today, given what we think its MPV is. And the trade-off with that with prudent balance sheet management.

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So we look at each line item asset by asset and really try to assess what we think of as the right approach. The other piece of it too is how well can you hedge that asset class, right? So in residential, we still have a pretty big position but we've just done such a fantastic job in hedging the asset class that we're generally comfortable with continuing to have a larger position reflecting purchases and sales during the quarter.

Commercial has been harder to hedge. I think what I described was taking it down another 5 billion since quarter end, reflecting that we thought there actually was a slightly better environment over the past several weeks to move some of those assets. But we are not going to move them at fire sale prices, we are going to move them at prices that make sense to us and monitor leverage accordingly. And so we do have a very strong disciplined program of how we would take assets down on the balance sheet, the according leverage benefits, but to do so, certainly in the context of what we think makes sense from a pricing perspective.

On the red cap side, the downgrade of the securities that took place a few weeks ago actually didn't have any meaningful impact on us at all from our regulatory capital position. So on the whole, as we talked about, the vast majority, 80% plus, of our securities that we carry, whether in residential form or commercial form, are AA and AAA. So we really didn't feel ourselves, I think it was felt more broadly in the market, any fall-out. So our capital ratios really didn't change materially since the end of the quarter.

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**Meredith Whitney** - *Oppenheimer - Analyst*

Okay, that's great to know. If I can follow up on one last question, which has to do with operating leverage, the other careful balancing act is opportunities in the marketplace that you don't want to miss out on in the future but also negative operating leverage while those opportunities don't evidence themselves immediately. Could you speak to that and how many quarters you would sit with negative operating leverage?

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**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

Yes, I think it's a very fair point. I've been trying to think about -- it's hard to say how many quarters, it's hard for me to predict how long the current environment continues. I know that what we're trying to do at the same time, I said reflected by some of the movements on assets, whether sales and purchases or outright sales, is to create that dry powder for the environment of opportunities that we anticipate will come our way.

We believe pretty strongly that once the fixed income asset classes in any part stabilize at all, that there's a sense of, we've kind of gotten to the bottom, that there will be a fantastic amount of interest in putting assets on at these pricing levels. So it is hard for me to say today how long out would we go with negative operating leverage, but I think all the actions that we're taking are really designed to set ourselves up for flexibility to take advantage of the environment when it turns, cognizant of keeping the balance sheet in a good spot while not giving up a lot of what we think is fundamentally lost intrinsic value at the moment, which has potential to come back.

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**Meredith Whitney** - *Oppenheimer - Analyst*

Thanks so much for the time.

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**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

You are welcome.

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**Operator**

Thank you. Our next question is going to be from Prashant Bhatia. You may ask your question and please state your company name.

**Prashant Bhatia** - Citi Group - Analyst

Hi, Prashant Bhatia of Citi Group.

**Erin Callan** - Lehman Brothers Holdings Inc. - CFO

Hi Prashant.

**Prashant Bhatia** - Citi Group - Analyst

Hi. Just, again, on the fed facility, can you talk a little bit about how you view that from an opportunity perspective? Is it you can delever in a more orderly way, or do you view that as something that you could use to help clients transact and maybe more from a revenue generation perspective?

**Erin Callan** - Lehman Brothers Holdings Inc. - CFO

It's truly the latter. So, we're not looking at it as a deleveraging mechanism. We look at it certainly, one, most importantly, as a statement of confidence to other counter parties in the market who provide repo financing on various asset classes, that there is an alternative. So I think it is just gives more comfort to those active providers today to continue to provide, which is in some ways a point of the facility to begin with.

But very much, your second point, which is we think it gives us a great opportunity to do more client business and, given the very attractive rates in margin haircuts that they put in place for the facility, and obviously we'll see where things are at the end of today after the fed meeting, it's just incredibly attractive. So I think, as shareholders, our ability to access that form of financing to do more business for clients is incredibly interesting, presents a very good opportunity.

**Prashant Bhatia** - Citi Group - Analyst

Okay. Great. And then you had mentioned you had executed two-thirds of the capital plan. Can you just elaborate on what was done and what needs to be done? What was the actual capital plan.

**Erin Callan** - Lehman Brothers Holdings Inc. - CFO

The capital plan, it was basically the refinancing needs for the year about 22 or so, 23 billion, just depending on how you looked at balance sheet growth. And what we've done so far, we've executed 16 billion. We did a large preferred stock deal, which was our full-year needs we executed in February, 1.9 billion, that we were going to do a smaller deal but we had the opportunity with great pricing to do a bigger one so we took care of our full year needs at that point.

We did a \$4 billion five-year bond deal back in January. Incredibly well received, great participation, great oversubscription. We've done a bunch of geographically diversified unsecured capital raises. We've raised capital in Singapore, we've raised it in Europe. So all over the globe, tapping into various sources.

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And then we do a pretty substantial amount of structured notes, which is a form of financing that's kind of away from the typical Capital Markets financing where we overlay some kind of option on equities for customers in more of a retail format. So the combination of all those getting to 16, the total needs for the year up in the low 20s, and really coming out of the gates as you can see in January and February in prefunding those requirements.

**Prashant Bhatia** - Citi Group - Analyst

Okay, great. And just a last question. On the 14.6 billion in residential mortgage, can you just break that down between prime and alt-A?

**Erin Callan** - Lehman Brothers Holdings Inc. - CFO

That's primarily alt-A. There's a pretty small component of prime in there. So if there's 1 billion of prime, that's probably the most that's in there.

**Prashant Bhatia** - Citi Group - Analyst

Okay, thank you.

**Operator**

Thank you, our next question is from Glenn Schorr. You may ask your question and please state your company name.

**Glenn Schorr** - UBS - Analyst

Thanks. UBS.

**Erin Callan** - Lehman Brothers Holdings Inc. - CFO

Hi, Glen.

**Glenn Schorr** - UBS - Analyst

Hello, Erin. Can you just maybe just give a little more color? I was curious on your earlier remarks on what you bought in the quarter that was attractive, and that obviously coincides with what you thought some marks were temporary as opposed to permanently marked down. I'm assuming it's the same asset class.

**Erin Callan** - Lehman Brothers Holdings Inc. - CFO

Yes, the activity really in purchases and sales took place in resi's. Close to 2 billion between sales and purchases in that asset class, and really in the alt-A space. We saw a great opportunity in what happened with alt-A pricing, around the Pelican fund, execution, transactions around that situation. So we were excited to have the ability to have some dry powder there and to get up the sale of some other assets, other agency-related product in order to buy what we thought was alt-A at a very good price.

We are very well hedged. I mean, it's always a little challenging how you look at it, we would consider ourselves at this point net short in the residential asset class.

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**Glenn Schorr** - UBS - Analyst

Net short in resi. So that would mean that wherever you bought it, to find a reasonable market, so you marked the whole portfolio down, and then the 10 points that we fell in the quarter, in March so far, you're kind of numb to it because you're hedged there still.

**Erin Callan** - Lehman Brothers Holdings Inc. - CFO

Exactly. And remember, despite whether we did actually buy or sell in the quarter, there was so much transparency around the Pelican situation, with respect to alt-A assets, the marks are going to be what they're going to be, right? So it really didn't matter that we happened to buy or sell assets at that point because we would have marked the book either way.

**Glenn Schorr** - UBS - Analyst

And what do you use to hedge alt-A? You have to use the ABX best alternative?

**Erin Callan** - Lehman Brothers Holdings Inc. - CFO

Yes, ABX best alternative, we also, in our minds at least, think about hedging through servicing. So I mentioned -- and some CMBX too, so CMBX was a new way for us to get hedged, as many people did over the course of last six months, we did buy servicing and we already had some servicing as I talked about, as you guys know, that's a pretty natural hedge to that portfolio. So a combination of factors, ABX, servicing, CMBX. And actually, just to clarify my point on being net short, it's really specific to subprime, not the entire residential asset class.

**Glenn Schorr** - UBS - Analyst

Got it. And then the 5 billion or so in the past three weeks on the commercial side, those are just straight-out sales?

**Erin Callan** - Lehman Brothers Holdings Inc. - CFO

Yes.

**Glenn Schorr** - UBS - Analyst

And were they liquidated in the range of where you had marked them?

**Erin Callan** - Lehman Brothers Holdings Inc. - CFO

Yea, absolutely. Actually when we looked at effectively how we thought about the cost of making those sales, makes me feel very, very good that we've marked our book obviously appropriately in the context of the market environment.

**Glenn Schorr** - UBS - Analyst

Cool. Okay. That's great. Last thing is, isn't your unencumbered bucket of assets, can you describe what's in there? In other words, does that include mortgages or is it mostly cash, bank deposits, and the really high, high end stuff?

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**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

Just to talk about the unencumbered collateral, I have Paolo Tonucci, my treasurer here. He's just going to make a comment about the unencumbered composition, just to give you some granularity on that.

**Paolo Tonucci** - *Lehman Brothers Holdings Inc. - Treasurer*

Sure, the majority of the unencumbered collateral is going to be corporate loans and the commercial mortgages. Some residential mortgages, and some securities that we're trading. The majority of securities are obviously within our broker dealer.

But there are some that will be outside the broker dealer for various reasons. The commercial mortgages, as Erin has mentioned, are low LTV and high quality, and very much financeable in a variety of secured funding forms. But we choose not to. We choose to leave those unencumbered and funded with long-term debt.

It's also worth noting that many of these assets in the illiquid assets exist within our bank entities and that's actually our preferred way of funding the more esoteric and illiquid asset classes across corporate loans, commercial whole loans, residential mortgages and even swap receivables.

**Glenn Schorr** - *UBS - Analyst*

Thanks for all the detail.

**Operator**

Our next question is from Jim Mitchell. You may ask your question and please state your company name.

**Jim Mitchell** - *Buckingham Research - Analyst*

Yes, good morning, Buckingham Research.

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

Hi, Jim.

**Jim Mitchell** - *Buckingham Research - Analyst*

Hi. Can you just maybe just to follow up on the unencumbered assets, can you say how much of that is pledgeable to the fed? Because obviously they're pretty wide open now, anything BBB rated or above. Is it fair to assume that a good portion of that is pledgeable to the fed?

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

It's fair to assume in terms of the quality of the collateral but the fed facility is available to the broker dealer. It's not available to the holding company. I want to be clear about that.

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**Jim Mitchell** - *Buckingham Research - Analyst*

Okay, fair enough. So that would be on the regulated side, the 99 billion.

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

Exactly.

**Jim Mitchell** - *Buckingham Research - Analyst*

One other follow-up question on the comp ratio. Obviously it was a little higher this quarter because of the lower revenues. If we were to see a more normalized revenue with less write-downs going forward, would that come back down to the 49.3 you were consistently doing, or is this a --

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

I think if we were so lucky to see a very improved revenue environment, that would be our intention. So I said we're just trying to not surprise people at the end of the year with a higher ratio in the fourth quarter and just trying to say we don't have a lot of visibility and we want to be fair about how we see it right now.

**Jim Mitchell** - *Buckingham Research - Analyst*

Right, fair enough. Okay, thanks.

**Operator**

Thank you. Our next question is from Brad Hintz. You may ask your question and please state your company name.

**Brad Hintz** - *Sanford Bernstein - Analyst*

Brad Hintz from Sanford Bernstein.

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

Hi Brad.

**Brad Hintz** - *Sanford Bernstein - Analyst*

Hey, how are you, Erin?

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

Good.

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**Brad Hintz** - *Sanford Bernstein - Analyst*

Question. What is the tenor of your commercial paper program right now? How much do you have outstanding?

**Paolo Tonucci** - *Lehman Brothers Holdings Inc. - Treasurer*

We had at the end of the quarter around 8 billion outstanding in both the U.S. and in Europe. That's the totality. As Erin said, around half of that has been allowed just to mature. We issue opportunistically. And as you know, Brad, we've never relied on CP to provide core funding. The remaining tenor I would say is now around two to three months.

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

So the remaining four is around average tenor of two to three months.

**Brad Hintz** - *Sanford Bernstein - Analyst*

I noticed that your double leverage ratio is 1.2. None of the other brokerage firms is above one. Could you talk about what your plans are with that?

**Paolo Tonucci** - *Lehman Brothers Holdings Inc. - Treasurer*

I think that's really a matter of timing. Our own measure of double leverage wouldn't give you -- we don't show, as we measure it, that the double leverage is greater than one.

**Brad Hintz** - *Sanford Bernstein - Analyst*

I'm sorry, I got mine from Moody's.

**Paolo Tonucci** - *Lehman Brothers Holdings Inc. - Treasurer*

Moody's excludes some form of capital that we treat as capital, as infusible capital into other entities within our measure. As we see it, it's 0.92, but that can also be affected just by the timing of repatriations and dividend payments.

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

But we're happy to discuss that with you Brad off-line if you want to go through more detail about it.

**Brad Hintz** - *Sanford Bernstein - Analyst*

Sure, that's fine. And then have you drawn under any of your committed facilities, committed repo, committed collateralized facilities, committed holding company revolver, or accessed the bidding channels under any of them?

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**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

No, we haven't, Brad. What I will say, though, just because I want to make a note about this is, we do frequently draw, over time, under our committed holding company facilities because that is part of our philosophy since '98, is we want to really be able to access those facilities on a regularly basis without signaling that there's an event or a problem at the Firm.

So we usually quite actively access those facilities. We have not accessed those in recent weeks or months, or maybe about a month ago. So it's -- there's nothing drawn at the moment, but we do actually pretty continuously take pieces down on the committed holdco facilities as a way to test the availability.

**Brad Hintz** - *Sanford Bernstein - Analyst*

Very good. An then the final question is, are you still making a market in your debt?

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

Yes, we are, very, very actively. So I think you could hear some good feedback from the market about our doing that in the past few days.

**Brad Hintz** - *Sanford Bernstein - Analyst*

Then is that -- is that what's used for marking the liability side, the \$600 million?

**Paolo Tonucci** - *Lehman Brothers Holdings Inc. - Treasurer*

We're obviously conscious of where we're trading debt, but we try and get external marks as well for Lehman paper that's being traded elsewhere.

**Brad Hintz** - *Sanford Bernstein - Analyst*

I see. Okay, great. Guys, thank you very much. Difficult time out there.

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

Thank you. Appreciate your support.

**Operator**

Thank you. Our next question is from Michael Hecht. You may ask your question and please state your company name.

**Michael Hecht** - *Banc of America Securities - Analyst*

Hi, guys. Mike Hecht from Banc of America, how are you doing?

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**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

Hi Mike, good, how are you?

**Michael Hecht** - *Banc of America Securities - Analyst*

I'm good thanks. Thanks for all the detail. You guys have answered most of the questions. I just have a few quick housekeeping things. The 600 million fair value mark on debt, did you allocate that across fixed income and equities just so we can get a sense of how it contributed to the results?

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

About 80/20, 80 to fixed income, 20 to equities.

**Michael Hecht** - *Banc of America Securities - Analyst*

Okay, and then I think you guys said the update on level three assets, but I had a number of like 42 billion at the end of the year. What was the number at the end of the quarter, and were there any shifts across the different asset class buckets within level three?

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

Yes, we did have some shifts across buckets at the end of the quarter so let me -- let me just give you some breakdowns on that. One sec. Transfers in, transfers out, just want to double-check it for you.

At the end of the quarter -- I mean, at the end of the year, we were about 38.8 in total level three assets. In terms of what happened in level three asset changes this quarter, we had net sort of payments, purchases, or sales of 1.8 billion. We had net transfers in of 1.1 billion. So stuff that was really moved in or recharacterized from level two. And then there was about 875 million of write-downs. So that gives you a balance of 38,682 as of February 29.

**Michael Hecht** - *Banc of America Securities - Analyst*

Looking at headcount at the end of the quarter, fell about 2% or 470 people or so. Any sense of how we can expect it to trend the rest of the year? Can you give us a sense of areas where you're making reductions?

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

I mentioned in remarks that we took down 1,100 since the end of the quarter. So that was incremental to where we were on February 29. And you probably saw that reported in the press last week.

So at this point we like the headcount against the opportunity set but it's really hard to judge. We are just going to stay on it, monitor it, see where the business opportunities are and how they change globally. So don't have any immediate plans to change that philosophy.

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**Michael Hecht** - *Banc of America Securities - Analyst*

Okay. Then just last question, to follow up on the question about leverage earlier, I saw that the net leverage ratio came down, the gross leverage ratio went up a bit. I guess if I look at net assets in dollars, they rose about 6%, and total assets about 14%, which seem to be mostly about 22% increase in your collateralized lending agreements, which I think you already touched on around your comments around repo, but just any other drivers in the increase, and over time while you're managing the net leverage ratio, should we expect the balance sheet to actually contract?

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

I think if we all remember what the day was like on February 29, which is kind of an intriguing day, which was the close of the quarter, there were just a bunch of sales that day from clients which actually ended up with a bigger balance sheet than we had anticipated. So changed after that fact but it was a pretty strange day in terms of getting everything straightened out.

As I mentioned, yes, our goal is to continue to take that leverage down with this kind of asset environment. In order to do so, the answer to that is that we will have -- we will sell assets as appropriate and within the right pricing context, to get to that outcome, and obviously continue to grow capital through retained earnings. So I don't see why there's any reason at this point to change off that course and we'll stay on that path until we see something about the environment that tells us we should behave differently.

**Michael Hecht** - *Banc of America Securities - Analyst*

Okay, great, makes sense. Thanks very much.

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

Thank you.

**Operator**

Our final question today is from Douglas Sipkin. You may ask your question and please state your company name.

**Douglas Sipkin** - *Wachovia - Analyst*

Yes, thanks. Douglas Sipkin from Wachovia. How are you, Erin?

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

Good, Doug. How are you doing?

**Douglas Sipkin** - *Wachovia - Analyst*

Not too bad. Just a couple of follow-ups. First off, I know you guys have always mentioned, talking about 2 trillion in bonds maturing. Can you update us on that, given where I guess historical spreads are for so many asset classes? I mean, how much longer do you think cash buyers are going to sit on the sidelines with spreads at record levels?



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**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

You know, it's funny, it's funny, Doug, because last night when I was looking over the earnings remarks, I actually struck the language that talks about fixed income buyers can't stay on the sidelines forever, because I said, well, you know, we said that last quarter, and it doesn't sound like it particularly changed. It's a tough call.

I agree with you when you look at everything maturing, principal and interest repayments, you've had reason for optimism that there's cash available to go back into these asset classes. I think the volatility is just going to have to come down a bit, the cash is there, and so there will be at some point that stability turning point. It's just still hard to predict when it is. I sort of deliberately took that out of the equation for now as we sit and watch, as we see investors get back with their confidence in the marketplace.

**Douglas Sipkin** - *Wachovia - Analyst*

But it's fair to assume, I guess with your balance sheet, that you guys have actually been able to get some price discovery and you guys felt the need to get opportunistic with some assets. And so – can we at least say in a general sense maybe there's some visibility coming back into the market? Obviously that's early days, but based on your actions.

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

You know, our actions were, I feel, I don't want to say any kind of strong statement here, because the chain of events could be totally different tomorrow but the actions of our purchases, one, reflect asset classes we're incredibly active and knowledgeable in, so we feel like we really understand the fundamentals and the technical trading aspects of those asset classes.

And two, very much reflected an opportunity on a day or moment in time, which might not necessarily even be the case today, but might have been the case on February 28, or some other day in the quarter, so I am hard-pressed to say, sort of see the light at the end of the tunnel yet here. There have been moments where there's been opportunities and those will continue to be out there and at some point will hopefully be the dominant theme but hard to say that's yet.

**Douglas Sipkin** - *Wachovia - Analyst*

And then the second question, I mean, obviously it's very unfortunate situation with what happened with one of your closest competitors, and for all the people that work there but from your perspective, this is pretty much your number one competitor in a host of businesses. I mean, obviously the core business you guys compete in is unbelievably depressed but how are you guys thinking about that from a competitive standpoint and the opportunity to pick up volume? I know you mentioned your core fixed income trading business was up 40%. How are you guys thinking about that over the next six months? There has to be massive opportunities to pick up market share.

**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

I think Doug it's fair to say, as you point out, we have great sympathy for our colleagues at Bear Stearns, and are all very sad about what happened to that organization. So, yes, I'm sure there will be opportunities for market share. Yes, did they have capabilities in some of our core competencies, absolutely. But there are so many other things that relate to the fallout from Bear Stearns that are so fundamental to our industry, that I would say it's hard at the moment to get too focused on what's the upside for us. I think there's a lot to be thought about for the industry as a whole related to that situation.

**Douglas Sipkin** - *Wachovia - Analyst*

Fair point. I appreciate your color there. Thank you.

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**Erin Callan** - *Lehman Brothers Holdings Inc. - CFO*

Okay. Well, thank you everyone for joining us. Hopefully the fact that the questions were a little lighter reflects that we were able to give you more information during the course of the remarks. As I think you know, we are very happy to answer any and all questions on any level of detail that people want to hear from us on, so feel free to call us, feel free to contact us, and I really want to thank those people on the phone that have supported us through what is a very difficult environment. We appreciate that. We appreciate the partnership and the confidence in our organization, and I want to say that on behalf of all of the executive committee of Lehman Brothers. So thank you for joining us today.

**Operator**

Thank you. This concludes today's conference. Thank you for participating. You may disconnect at this time.

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