

*Confidential Presentation to:*

2008 Budget  
Status Update

*October 4, 2007*

LEHMAN BROTHERS

# 2005-2007 Financial Trend

- ◆ 2007 forecasted revenues for the Firm are in line with the 2007 Original Budget, but 9% below the projections from the Mid Year Business Reviews

\$ millions, percent

	2005 Actuals	2006 Actuals	2007 Budget	2007 MY Projection	2007 Forecast	2005 - 2006A % Chg <sup>(1)</sup>	2007F - 2006A % Chg <sup>(1)</sup>
<b>Divisional Revenues:</b>							
Fixed Income	8,530	9,027	9,800	9,300	7,550	6%	-16%
Equities	3,117	4,030	4,500	5,700	5,950	29%	48%
Banking	3,132	3,338	3,700	4,500	3,400	7%	2%
Investment Management	1,979	2,349	2,758	2,872	2,853	19%	21%
Principal Investing	312	932	1,116	2,050	1,588	199%	70%
Non Core/Other	(2,440)	(2,094)	(2,224)	(2,822)	(1,741)	14%	17%
<b>Total</b>	<b>14,630</b>	<b>17,583</b>	<b>19,650</b>	<b>21,600</b>	<b>19,600</b>	<b>20%</b>	<b>11%</b>
<b>Shadow Revenues:</b>							
Mortgage Capital Division	1,835	1,237	1,445	793	(114)	-33%	-109%
Europe	3,157	4,066	4,670	6,219	5,600	29%	38%
Asia	1,515	1,659	2,150	2,400	2,400	10%	45%
Compensation	7,213	8,669	9,687	10,649	9,663	20%	11%
NPE	2,588	3,009	3,500	3,600	3,739	16%	24%
<b>Total Expenses</b>	<b>9,801</b>	<b>11,678</b>	<b>13,187</b>	<b>14,249</b>	<b>13,402</b>	<b>19%</b>	<b>15%</b>
<b>Pre Tax Income</b>	<b>4,829</b>	<b>5,905</b>	<b>6,463</b>	<b>7,351</b>	<b>6,198</b>	<b>22%</b>	<b>5%</b>
Taxes	1,569	1,945	2,133	2,352	1,866	24%	-4%
Cumulative Effect of Accounting Change	-	47	-	-	-		
<b>Net Income</b>	<b>3,260</b>	<b>4,007</b>	<b>4,330</b>	<b>4,999</b>	<b>4,332</b>	<b>23%</b>	<b>8%</b>
Earnings per Common Share	\$ 5.43	\$ 6.81	\$ 7.41	\$ 8.58	\$ 7.50	25%	10%
Return on Equity	21.6%	23.4%	21.7%	24.6%	21.4%	1.8%	-2.0%
Return on Tangible Equity	27.8%	29.1%	26.3%	30.2%	26.4%	1.3%	-2.7%
Compensation Ratio	49.3%	49.3%	49.3%	49.3%	49.3%	0.0%	0.0%
NPE/Revenue	17.7%	17.1%	17.8%	16.7%	19.1%	-0.6%	2.0%
Book Value per Share	\$ 28.75	\$ 33.87	\$ 38.29	\$ 40.29	\$ 39.91	18%	18%
Pre Tax margin	33.0%	33.6%	32.9%	34.0%	31.6%	0.6%	-2.0%
Effective Tax Rate	32.5%	32.9%	33.0%	32.0%	30.1%	0.4%	-2.8%

<sup>(1)</sup> Absolute change for ROE, ROTC, Compensation Ratio, Pre Tax Margin and Effective Tax Rate

# Updated Road to \$35B

- ◆ Our current revenue projection for 2007 is 9% below our projection from the Mid Year Business Reviews. As a result, the CAGR required to get to \$35B in revenues by 2010 has grown from 17% (3 Year Financial Plan from Sun Valley) to 21%

## Sun Valley Forecast

	2007 Forecast	2008 Projection	2009 Projection	2010 Projection	CAGR '07 - '10
Revenues:					
Fixed Income	9,300	10,780	12,500	14,500	16%
Equities	5,700	6,758	8,012	9,500	19%
Banking	4,100	4,780	5,574	6,500	17%
Investment Mgmt	2,872	3,336	3,874	4,500	16%
Principal Investing	2,050	2,604	3,307	4,200	27%
Non Core/Other	(2,422)	(3,068)	(3,589)	(4,200)	20%
Total	21,600	25,189	29,678	35,000	17%
Shadow Revenues:					
Mortgage Capital	500	721	1,040	1,500	44%
Europe	6,219	7,354	8,996	11,000	21%
Asia	2,400	2,941	3,641	4,500	23%

## Current Forecast

	2007 Forecast	2008 Projection	2009 Projection	2010 Projection	CAGR '07 - '10
Revenues:					
Fixed Income	7,550	9,385	11,665	14,500	24%
Equities	5,950	6,954	8,128	9,500	17%
Banking	3,400	4,220	5,237	6,500	24%
Investment Mgmt	2,853	3,321	3,866	4,500	16%
Principal Investing	1,588	2,196	3,037	4,200	38%
Non Core/Other	(1,741)	(2,460)	(3,260)	(4,200)	34%
Total	19,600	23,616	28,673	35,000	21%
Shadow Revenues:					
Mortgage Capital	(114)	142	462	1,500	n/m
Europe	5,600	7,013	8,783	11,000	25%
Asia	2,400	2,959	3,649	4,500	23%

# Year over Year Growth Analysis

◆ Currently, the 2008 Budget submission of \$23.0B is \$0.6B, or 3%, below the updated road to \$35B projection

\$ millions, percent

	2007 Forecast	2008 Submitted Budget	2008 Projection <sup>(2)</sup>	2008B - 2007F % Chg <sup>(1)</sup>	2008P - 2007F % Chg <sup>(1)</sup>
<b>Divisional Revenues:</b>					
Fixed Income	7,550	9,500	9,385	26%	24%
Equities	5,950	6,600	6,954	11%	17%
Banking	3,400	4,100	4,220	21%	24%
Investment Management	2,853	3,335	3,321	17%	16%
Principal Investing <sup>(3)</sup>	1,588	2,000	2,196	26%	38%
Non Core/Other	(1,741)	(2,535)	(2,460)	-46%	-41%
<b>Total</b>	<b>19,600</b>	<b>23,000</b>	<b>23,616</b>	<b>17%</b>	<b>20%</b>
<b>Shadow Revenues:</b>					
Mortgage Capital Division	(114)	900	142	n/m	n/m
Europe	5,600	6,500	7,013	16%	25%
Asia	2,400	3,300	2,959	38%	23%
Compensation	9,663	11,316	11,619	17%	20%
NPE	3,739	4,100	4,100	10%	10%
<b>Total Expenses</b>	<b>13,402</b>	<b>15,416</b>	<b>15,719</b>	<b>15%</b>	<b>17%</b>
<b>Pre Tax Income</b>	<b>6,198</b>	<b>7,584</b>	<b>7,897</b>	<b>22%</b>	<b>27%</b>
Taxes	1,866	2,389	2,488	28%	33%
Cumulative Effect of Accounting Change	-	-	-		
<b>Net Income</b>	<b>4,332</b>	<b>5,195</b>	<b>5,409</b>	<b>20%</b>	<b>25%</b>
Earnings per Common Share	\$ 7.50	\$ 9.02	\$ 9.40	20%	25%
Return on Equity	21.4%	21.8%	22.6%	0.4%	1.2%
Return on Tangible Equity	26.4%	26.2%	27.2%	-0.2%	0.8%
Compensation Ratio	49.3%	49.2%	49.2%	-0.1%	-0.1%
NPE/Revenue	19.1%	17.8%	17.4%	-1.3%	-1.7%
Book Value per Share	\$ 39.91	\$ 47.54	\$ 47.93	19%	20%
Pre Tax margin	31.6%	33.0%	33.4%	1.4%	1.8%
Effective Tax Rate	30.1%	31.5%	31.5%	1.4%	1.4%

<sup>(1)</sup> Absolute change for ROE, ROTE, Compensation Ratio, Pre Tax Margin and Effective Tax Rate

<sup>(2)</sup> Current Road to \$35B

<sup>(3)</sup> No official submission. Finance Estimate

## 2008 New Initiatives

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- ◆ Recommend using a conservative approach for the 2008 new initiatives to maintain comp flexibility in an uncertain environment
  - Give \$150-200 million to the divisions and regions upfront
  - Assess the outlook for 2008 at the end of Q1 and distribute second round of new initiatives if warranted
  - Use some of the compensation “surplus” generated by the growth in revenues in order to:
    - Increase in compensation of the existing employee base
      - Not credible to keep compensation flat and grow revenues by 17%
    - Reduction in the compensation & benefits ratio to boost margins, EPS and ROE
      - Will send a strong signal to the investor community that our investments are starting to pay off
  
- ◆ Suggest a two-pronged approach to the first round distribution of the 2008 new initiatives
  - \$150 million distributed upfront to the divisions and regions
    - Skew distribution towards the larger divisions and Europe and Asia
  - \$20-30 million earmarked for Firm-wide strategic investments
    - E.g., India, Russia, Turkey, China, Brazil – Final list to be agreed upon by the Executive Committee

## 2008 New Initiative Strawman

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- ◆ Recommend the following allocation of the first round of new initiatives
  - As in previous years, Front Office new initiatives also include Corporate-related costs (“Front to Back” costing)
  - Corporate new initiatives are for non-discretionary items (e.g., new regulatory requirements)

*\$ millions*

	<u>Americas</u>	<u>Europe</u>	<u>Asia</u>	<u>Total</u>
FID	5	10	10	<b>25</b>
Equities	5	10	10	<b>25</b>
IBD	5	10	10	<b>25</b>
IMD	5	10	5	<b>20</b>
Principal Investing	-	5	15	<b>20</b>
MCD	5	5	-	<b>10</b>
<b>Sub Total</b>	<b>25</b>	<b>50</b>	<b>50</b>	<b>125</b>
Corporate	5	10	10	<b>25</b>
<b>Grand Total</b>	<b>30</b>	<b>60</b>	<b>60</b>	<b>150</b>

- ◆ Suggest putting a process in place that will evaluate second round new initiative requests and make recommendations to the Executive Committee