

April 3, 2008

**Summary:**  
**Lehman Brothers Holdings Inc.**

**Primary Credit Analyst:**

Diane Hinton, New York (1) 212-438-4415; [diane\\_hinton@standardandpoors.com](mailto:diane_hinton@standardandpoors.com)

**Secondary Credit Analysts:**

Scott Sprinzen, New York (1) 212-438-7812; [scott\\_sprinzen@standardandpoors.com](mailto:scott_sprinzen@standardandpoors.com)  
Tanya Azarchs, New York (1) 212-438-7365; [tanya\\_azarchs@standardandpoors.com](mailto:tanya_azarchs@standardandpoors.com)

**Table Of Contents**

---

Rationale

Outlook

## Summary:

# Lehman Brothers Holdings Inc.

**Credit Rating:** A+/Negative/A-1

## Rationale

Standard & Poor's Ratings Services' ratings on Lehman Brothers Holdings Inc. (Lehman) continue to reflect the firm's sound franchise, which increasingly exhibits greater diversification in both product offering and geographic reach. The ratings also reflect Lehman's strong risk-management culture and prudent liquidity and funding profile. These strengths are tempered by the firm's continued relative concentration in fixed-income activities, which--as has been the case in recent quarters--can negatively affect operating performance in weak credit markets.

Although increasingly diversified, Lehman's business mix is skewed toward the fixed-income sector (where it remains a market-maker), with a relative focus on mortgages, structured finance, and credit products. The downturn in the U.S. housing market, and continued dislocation in global credit markets have prompted Lehman to realign its mortgage business. The firm closed one of its U.S. mortgage origination units in 2007, and, more recently, suspended wholesale and correspondent origination activities at another unit. We view Lehman's ability to scale its cost base to adapt to market conditions favorably, given the decline in revenues that current market conditions have engendered.

Lehman maintains an excellent risk culture, which results in the firm's comparatively lower risk appetite than that of peers, and its strong liquidity and funding profile. Management has, and continues to implement a number of measures to ensure Lehman's ability to meet its funding obligations, even in a stressed environment. The firm's access to external sources of funding remains sound, as reflected in its recent \$4 billion convertible preferred stock issue, which was oversubscribed. Overall, and despite nervous investor and media sentiment in recent weeks, Lehman has maintained a very stable funding structure that ensures that the firm has sufficient liquidity to meet all of its funding obligations in all market environments. The company's excess liquidity position is among the largest proportionately of the U.S. broker-dealers, and its sources-to-uses ratio is the strongest. Nevertheless, we cannot ignore the possibility that the firm could suffer severely if there is an adverse change in market perception, however ill-founded. In this respect, we take comfort in the broker-dealers' ability to access the Federal Reserve's discount window.

Lehman's earnings performance has held up relatively well under current market conditions, with net revenue of \$3.5 billion posted in first-quarter 2008 despite additional write-downs on troubled assets. Although the firm's fixed-income business continues to be pressured by the slowdown in activity, while also absorbing the majority of write-downs, the business's underlying strengths allow it to remain profitable. Nevertheless, consolidated net revenues declined 20% quarter-on-quarter owing to \$1.8 billion (net of hedges) in write-downs. As a result, Lehman's pretax margin dropped to 18.9% in the quarter despite a modest decline in operating expenses.

## **Outlook**

The negative outlook is in line with those on the other major global securities firms and investment banks. Given ongoing challenges for these firms in the current market environment, we believe that there is potential for a more substantial decline in profitability from capital market activities. We currently believe net revenues could decline by 20% to 30% (adjusting for write-downs) year-on-year. While such a decline could still be accommodated within the current ratings level, the ratings could be called into question if economic conditions substantially deteriorate and market turmoil persists to the extent that a more precipitous decline in earnings occurs during the next few quarters. In addition, and notwithstanding supportive actions by the Federal Reserve, we are increasingly concerned about the independent broker-dealers' heavy reliance on wholesale funding, given the protracted period of market illiquidity.

As economic conditions continue to unfold throughout 2008, the outlook on Lehman could revert to stable if a resumption of more normal market conditions contributes to strong and more consistent earnings over a number of quarters.

Copyright © 2008, Standard & Poors, a division of The McGraw-Hill Companies, Inc. (?S&P?). S&P and/or its third party licensors have exclusive proprietary rights in the data or information provided herein. This data/information may only be used internally for business purposes and shall not be used for any unlawful or unauthorized purposes. Dissemination, distribution or reproduction of this data/information in any form is strictly prohibited except with the prior written permission of S&P. Because of the possibility of human or mechanical error by S&P, its affiliates or its third party licensors, S&P, its affiliates and its third party licensors do not guarantee the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. S&P GIVES NO EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. In no event shall S&P, its affiliates and its third party licensors be liable for any direct, indirect, special or consequential damages in connection with subscriber?s or others? use of the data/information contained herein. Access to the data or information contained herein is subject to termination in the event any agreement with a third-party of information or software is terminated.

Analytic services provided by Standard & Poor's Ratings Services (Ratings Services) are the result of separate activities designed to preserve the independence and objectivity of ratings opinions. The credit ratings and observations contained herein are solely statements of opinion and not statements of fact or recommendations to purchase, hold, or sell any securities or make any other investment decisions. Accordingly, any user of the information contained herein should not rely on any credit rating or other opinion contained herein in making any investment decision. Ratings are based on information received by Ratings Services. Other divisions of Standard & Poor's may have information that is not available to Ratings Services. Standard & Poor's has established policies and procedures to maintain the confidentiality of non-public information received during the ratings process.

Ratings Services receives compensation for its ratings. Such compensation is normally paid either by the issuers of such securities or third parties participating in marketing the securities. While Standard & Poor's reserves the right to disseminate the rating, it receives no payment for doing so, except for subscriptions to its publications. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).

Any Passwords/user IDs issued by S&P to users are single user-dedicated and may ONLY be used by the individual to whom they have been assigned. No sharing of passwords/user IDs and no simultaneous access via the same password/user ID is permitted. To reprint, translate, or use the data or information other than as provided herein, contact Client Services, 55 Water Street, New York, NY 10041; (1)212.438.9823 or by e-mail to: [research\\_request@standardandpoors.com](mailto:research_request@standardandpoors.com).

Copyright © 1994-2008 Standard & Poors, a division of The McGraw-Hill Companies. All Rights Reserved.



Standard & Poor's RatingsDirect | April 3, 2008

4

640895 | 30000508