A publication of
WACHOVIA CAPITAL MARKETS, LLC

Equity Research

Lehman Brothers Holdings Inc.

LEH: Tough Year Ahead--Sowing Seeds For Share Gains

Outperform

Sector: Brokers, Market Weight
January 15, 2008

Company Note

- **LOW- TO MID-TEEN ROE IS RESPECTABLE.** We recently held a client meeting with new CFO Erin Callan. The overall tone of the meeting was cautious given the challenging operating environment. However, we believe LEH is well positioned to capitalize once market conditions ease. We expect 2008 ROE in the low- to mid-teens in light of current market conditions; we find this respectable given how competitors have experienced dilution via capital infusions and have aggressively marked down assets.
- **CRE AND CDS EXPOSURES SEEM MANAGEABLE.** Commercial mortgage-related exposure at the end of 4Q was approximately $40bn. However, portfolio characteristics are stable (2 year average life, 2/3 of portfolio has LTVs under 60%, vast majority is floating rate, strong diversity with 50% in US, 25% in Europe and 25% in Asia). In CDS, 95% of counterparties are investment grade. Counterparties post collateral and are marked to market on a daily basis. The only exception to collateral posting is the monolines. However, LEH has utilized intermediaries to offset the risk and historically has done little with firms that do not post collateral.
- **MARKET SHARE GAINS IN ADVISORY AND PRIME BROKERAGE.** LEH sees opportunities to gain market share as competitors continue to struggle. Market share opportunities are apparent in advisory. Stability at LEH is an attractive selling point to banking clients. LEH is also seeing market share gains in prime brokerage. Similar to LEH's advisory clients, hedge fund clients are positioning their business to prime brokerages that have solid operations despite the market downturn. We note after the 2001-2003 recession, LEH gained meaningful market share as it kept its business intact during the bear market. We envision a similar scenario manifesting over time.
- **BALANCE SHEET FLEXIBILITY IS KEY.** LEH is more focused on balance sheet flexibility and liquidity. Capital allocation is critical at this juncture, in our view, since many LEH businesses see opportunities given the market dislocation. LEH does not need to raise equity like some of its competition.

Valuation Range: $71 to $72
We believe the stock will trade in a range of $71-72 per share based on a multiple of 1.8x estimated Q1 2008 book value. Risks to this valuation range include a material decline in primary and secondary debt markets and decreased penetration in European markets.

Investment Thesis:
LEH remains well positioned to benefit from a favorable interest rate environment as well as a recovery in the IPO and advisory markets, in our view.

	2007A	2008E		2009E	
EPS		**Curr.**	**Prior**	**Curr.**	**Prior**
Q1 (Feb.)	$1.96	$1.70	NC	$1.80	NC
Q2 (May)	2.21	1.79	NC	1.75	NC
Q3 (Aug.)	1.54	1.78	NC	2.00	NC
Q4 (Nov.)	1.54	1.66	NC	1.83	NC
FY	$7.26	$6.92	NC	$7.38	NC
CY	NE	NE		NE	
FY P/E	7.7x	8.1x		7.6x	
Rev.(MM)	$19,257.0	$19,159.0		$19,594.0	

Source: Company Data, Wachovia Capital Markets, LLC estimates, and Reuters
NA = Not Available, NC = No Change, NE = No Estimate, NM = Not Meaningful

Ticker	LEH
Price (01/15/2008)	$55.71
52-Week Range:	$49-87
Shares Outstanding: (MM)	564.0
Market Cap.: (MM)	$31,420.4
S&P 500:	1,381.77
Dividend/Yield:	$0.48/0.9%
LT Debt: (MM)	$119,744.0
LT Debt/Total Cap.:	84.6%
ROE:	17.0%
3-5 Yr. Est. Growth Rate:	13.0%
CY 2008 Est. P/E-to-Growth:	NM
Last Reporting Date:	12/13/2007 *Before Open*

Source: Company Data, Wachovia Capital Markets, LLC estimates, and Reuters

Financial Services

Douglas Sipkin, CFA, Senior Analyst
(212) 214-8025 / douglas.sipkin@wachovia.com
Herman Chan, Associate Analyst
(212) 214-8037 / herman.chan@wachovia.com
Warren Gardiner, Associate Analyst
(212) 214-8068 / warren.gardiner@wachovia.com

Please see page 3 for rating definitions, important disclosures and required analyst certifications.

Company Description:
Spun out from American Express in 1994, Lehman Brothers is now one of the leading global investment banks, serving institutional, corporate, government and high-net-worth individuals throughout the world.

MID-TEEN ROE IS RESPECTABLE. We recently held a client meeting with new CFO Erin Callan. The overall tone of the meeting was cautious given the challenging operating environment. However, we believe LEH is well positioned to capitalize once market conditions ease. We expect 2008 ROE in the low- to mid-teens in light of current market conditions; we find this respectable given how competitors have experienced dilution via capital infusions and have aggressively marked down assets. We do not expect LEH to raise equity like some competitors.

MARKET SHARE GAINS IN ADVISORY AND PRIME BROKERAGE. LEH sees opportunities to gain market share as competitors continue to struggle. Market share opportunities are apparent in advisory. Stability at LEH is an attractive selling point to banking clients. LEH is also seeing market share gains in prime brokerage. Similar to LEH's advisory clients, hedge fund clients are positioning their business to prime brokerages that have solid operations despite the market downturn. In addition, LEH is well positioned for financial equity offerings considering its leading industry ranking. While likely less visible now, we do believe market share gains will become more apparent when conditions improve. We note after the 2001-2003 recession, LEH gained meaningful market share as it kept its business intact during the bear market. We envision a similar scenario manifesting over time.

CRE AND CDS EXPOSURES SEEM MANAGEABLE. Commercial mortgage-related exposure at the end of 4Q was approximately $40bn. However, portfolio characteristics are stable (2 year average life, 2/3 of portfolio has LTVs under 60%, vast majority is floating rate, strong diversity with 50% in US, 25% in Europe and 25% in Asia). In terms of CRE exposure, LEH has about $20bn in whole loans, $10bn in CMBS securities, and the remaining in various assets such as mezzanine loans. Management stressed that despite the poor recent CMBX performance, LEH's CMBS assets will not be marked to the same magnitude. Only 5-7% of the portfolio is marked against the CMBX. Actual individual trades in the market are performing better than the CMBX, and LEH primarily uses specific trades as a proxy for mark to market purposes.

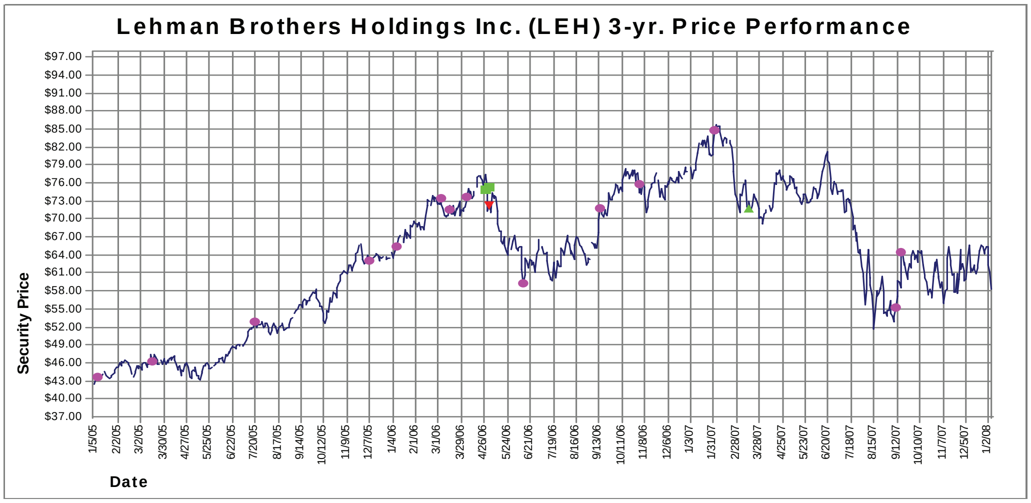
Management also gave some additional color on the CDS market. Conceding that LEH is a major player in the space, management nonetheless believes that certain measures are in place to limit counterparty risk. As disclosed on the Q4 earnings call, 95% of counterparties are investment grade. Secondly, counterparties post collateral and are marked to market on a daily basis. The only exception to collateral posting is the monolines. However, LEH has utilized intermediaries to offset the risk and historically has done little with firms that do not post collateral.

It is no surprise that the Fixed Income business will likely struggle in 2008. LEH looks to offset poor performance in structured products and private equity with strength in credit trading, interest rate products, and commodities.

BALANCE SHEET FLEXIBILITY IS KEY. LEH is more focused on balance sheet flexibility and liquidity. Capital allocation is critical at this juncture, in our view, since many LEH businesses see opportunities given the market dislocation. Obtaining unsecured financing is difficult in the current environment. LEH has opted for shorter term capital at wider spreads in the interim. As evidence of this, LEH raised $4bn in five-year senior MTNs on January 15. Management mentioned that the $4bn debt offering represents 20% of LEH's total funding needs for 2008.

TOUGH TIMES BUT WE THINK DISCLOCATION WILL BENEFIT LEH IN THE LONG RUN. 2008 is shaping up to be a tough year across the board. However, we believe by keeping the balance sheet, culture, and talent intact, LEH has a terrific opportunity to take share from some of its competition. These are the periods where meaningful share gains are had. They usually do not come in bull markets.

Required Disclosures



	Date	Publication Price ($)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price ($)
	1/5/2005		Sipkin			
	1/5/2005	NA	1	46.00	48.00	42.47
●	1/10/2005	NA	1	47.50	49.50	43.69
●	3/16/2005	NA	1	52.50	55.00	46.20
●	7/20/2005	NA	1	60.00	62.50	52.90
●	12/6/2005	NA	1	65.00	67.50	63.08
●	1/10/2006	NA	1	68.50	71.00	65.27
●	3/3/2006	NA	1	73.50	76.50	73.35
●	3/15/2006	NA	1	75.50	77.50	71.58
●	4/5/2006	NA	1	82.50	85.00	73.72
❒	4/28/2006		2:1 stock split			
▼ ●	5/2/2006	NA	2	73.00	76.00	72.33
●	6/13/2006	NA	2	68.00	72.00	59.11
●	9/14/2006	NA	2	71.00	73.00	71.79
●	11/2/2006	NA	2	79.00	84.00	75.74
●	2/1/2007	NA	2	88.00	91.00	84.82
▲ ●	3/14/2007	NA	1	84.00	86.00	71.72
●	9/11/2007	53.85	1	66.00	68.00	55.18
●	9/18/2007	64.49	1	71.00	72.00	64.49

Source: Wachovia Capital Markets, LLC estimates and Reuters data

Symbol Key
- ▼ Rating Downgrade
- ▲ Rating Upgrade
- ● Valuation Range Change
- ◆ Initiation, Resumption, Drop or Suspend
- ■ Analyst Change
- ❒ Split Adjustment

Rating Code Key
- 1 Outperform/Buy
- 2 Market Perform/Hold
- 3 Underperform/Sell
- SR Suspended
- NR Not Rated
- NE No Estimate

Additional Information Available Upon Request

I certify that:
1) All views expressed in this research report accurately reflect my personal views about any and all of the subject securities or issuers discussed; and
2) No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by me in this research report.

- Wachovia Capital Markets, LLC or its affiliates managed or comanaged a public offering of securities for Lehman Brothers Holdings Inc. within the past 12 months.
- Wachovia Capital Markets, LLC or its affiliates intends to seek or expects to receive compensation for investment banking services in the next three months from Lehman Brothers Holdings Inc.
- Wachovia Capital Markets, LLC or its affiliates received compensation for investment banking services from Lehman Brothers Holdings Inc. in the past 12 months.
- Lehman Brothers Holdings Inc. currently is, or during the 12-month period preceding the date of distribution of the research report was, a client of Wachovia Capital Markets, LLC. Wachovia Capital Markets, LLC provided investment banking services to Lehman Brothers

Holdings Inc.

Risks to this valuation range include a material decline in primary and secondary debt markets and decreased penetration in European markets.

Wachovia Capital Markets, LLC does not compensate its research analysts based on specific investment banking transactions. WCM's research analysts receive compensation that is based upon and impacted by the overall profitability and revenue of the firm, which includes, but is not limited to investment banking revenue.

STOCK RATING

1 = Outperform: The stock appears attractively valued, and we believe the stock's total return will exceed that of the market over the next 12 months. BUY

2 = Market Perform: The stock appears appropriately valued, and we believe the stock's total return will be in line with the market over the next 12 months. HOLD

3 = Underperform: The stock appears overvalued, and we believe the stock's total return will be below the market over the next 12 months. SELL

SECTOR RATING

O = Overweight: Industry expected to outperform the relevant broad market benchmark over the next 12 months.

M = Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.

U = Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.

VOLATILITY RATING

V = A stock is defined as volatile if the stock price has fluctuated by +/-20% or greater in at least 8 of the past 24 months or if the analyst expects significant volatility. All IPO stocks are automatically rated volatile within the first 24 months of trading.

As of: January 15, 2008

47% of companies covered by Wachovia Capital Markets, LLC Equity Research are rated Outperform.

Wachovia Capital Markets, LLC has provided investment banking services for 40% of its Equity Research Outperform-rated companies.

52% of companies covered by Wachovia Capital Markets, LLC Equity Research are rated Market Perform.

Wachovia Capital Markets, LLC has provided investment banking services for 32% of its Equity Research Market Perform-rated companies.

2% of companies covered by Wachovia Capital Markets, LLC Equity Research are rated Underperform.

Wachovia Capital Markets, LLC has provided investment banking services for 21% of its Equity Research Underperform-rated companies.

Additional Disclosures For International Clients

For additional disclosure information please go to: www.wachoviaresearch.com

The securities and related financial instruments described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. For certain non-U.S. institutional readers (including readers in the EEA), this report is distributed by Wachovia Securities International Limited. For the purposes of Section 21 of the U.K. Financial Services and Markets Act 2000, this report has been approved by Wachovia Securities International Limited. This research is not intended for, and should not be relied on by, private customers. Please consult your Financial Advisor or the Wachovia Securities office in your area for additional information. U.S. residents are directed to wachovia.com for investment and related services.

For Wachovia Securities International Limited's policy for managing conflicts of interest in connection with research, please go to: www.wachoviaresearch.com/conflicts

Important Information for Japanese Recipients

This material is distributed in Japan by Wachovia Securities (Japan) Co., Ltd., a foreign securities company registered with the Financial Services Agency in Japan.

Important Information for Australian Recipients

Wachovia Capital Markets, LLC ("WCM") is exempt from the requirements to hold an Australian financial services license in respect of the financial services it provides to wholesale clients in Australia. WCM is a registered broker-dealer registered with the U.S. Securities and Exchange Commission, and a member of the New York Stock Exchange, the National Association of Securities Dealers, Inc. and the Securities Investor Protection Corp. WCM is regulated under U.S. laws which differ from Australian laws. Any offer or documentation provided to you by WCM in the course of providing the financial services will be prepared in accordance with the laws of the United States and not Australian laws.

Additional Disclosures

WCM is a U.S. broker-dealer registered with the U.S. Securities and Exchange Commission and a member of the New York Stock Exchange, the Financial Industry Regulatory Authority and the Securities Investor Protection Corp. Wachovia Securities International Limited is a U.K. incorporated investment firm authorized and regulated by the Financial Services Authority.

This report is for your information only and is not an offer to sell, or a solicitation of an offer to buy, the securities or instruments named or described in this report. Interested parties are advised to contact the entity with which they deal, or the entity that provided this report to them, if they desire further information. The information in this report has been obtained or derived from sources believed by Wachovia Capital Markets, LLC, to be reliable, but Wachovia Capital Markets, LLC, does not represent that this information is accurate or complete. Any opinions or estimates contained in this report represent the judgment of Wachovia Capital Markets, LLC, at this time, and are subject to change without notice. For the purposes of the U.K. Financial Services Authority's rules, this report constitutes impartial investment research. Each of Wachovia Capital Markets, LLC, and Wachovia Securities International Limited is a separate legal entity and distinct from affiliated banks.

SECURITIES: NOT FDIC-INSURED/NOT BANK-GUARANTEED/MAY LOSE VALUE