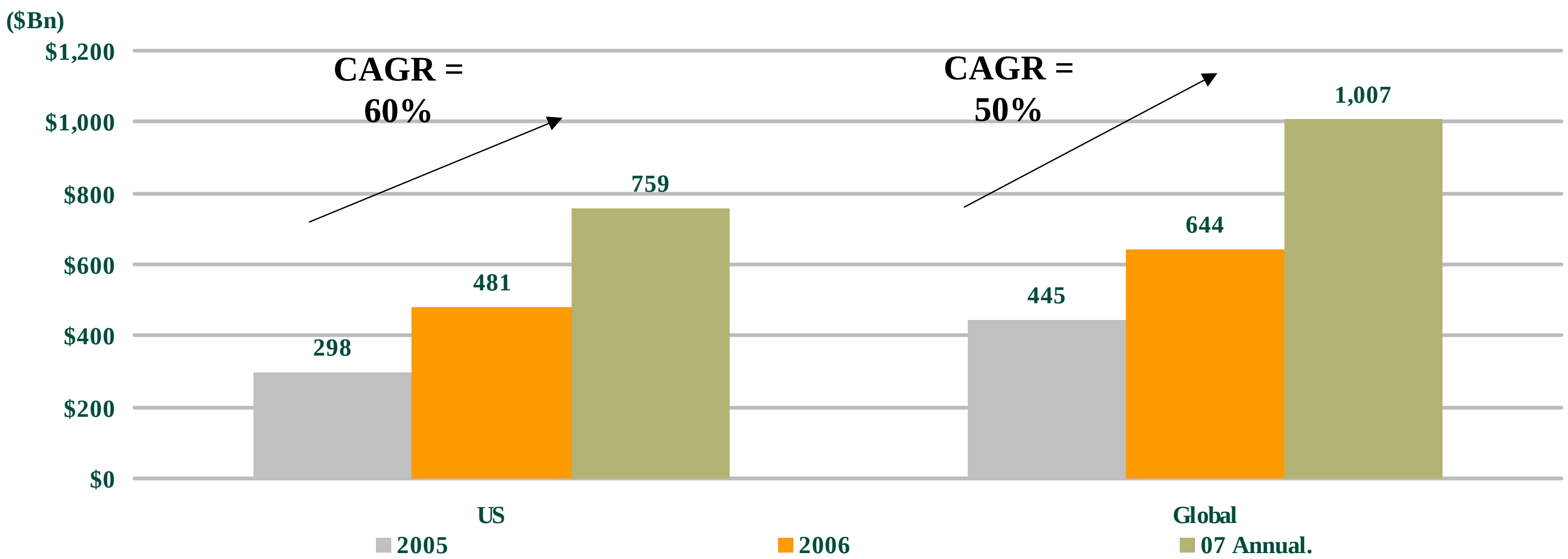
Leveraged Finance Risk

June 2007

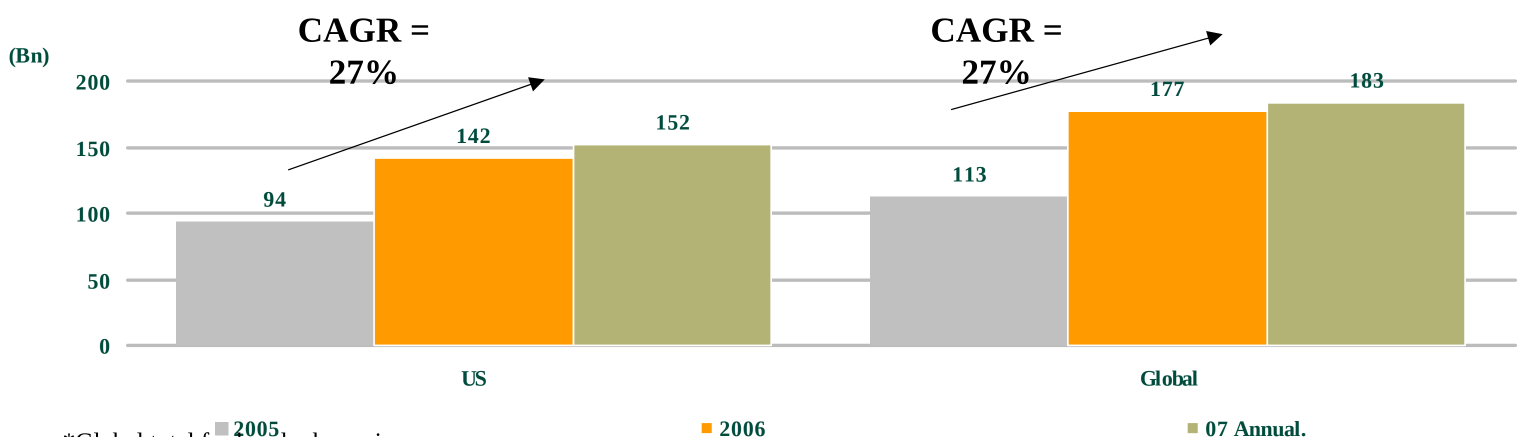
LEHMAN BROTHERS

The leverage finance market has been growing rapidly

Leverage Loans



Bonds



*Global total for bonds shown in currency.

Our Market Share and rank have improved this year both in the U.S. and Globally for Leveraged Finance

Leverage Loans

	2007*			2006			Δ		
	Amount ($mm)	**Share**	**Rank**	**Amount ($mm)**	**Share**	**Rank**	**Amount ($mm)**	**Share**	Rank
Global Leveraged Loans	$52,771.6	3.8%	8	$34,282.7	2.9%	12	$18,488.90	↑0.9%	↑4
US Leveraged Loans	$37,618.6	4.0%	8	$23,424.3	3.0%	9	$14,194.30	↑1.0%	↑1

Bonds

	2007*			2006			Δ		
	Amount ($mm)	**Share**	**Rank**	**Amount ($mm)**	**Share**	**Rank**	**Amount ($mm)**	**Share**	**Rank**
Global HY	$11,820.4	6.5%	7	$9,654.5	5.5%	9	$2,165.90	↑1.0%	↑2
HY US	$11,482.4	7.6%	5	$9,020.3	6.4%	7	$2,462.10	↑1.2%	↑2

*Annualized 2007

Our Market Share and rank have improved this year both in the U.S. and Globally for Financial Sponsors

Leverage Loans

	2007*			2006			Δ		
	Amount ($mm)	**Share**	**Rank**	**Amount ($mm)**	**Share**	**Rank**	**Amount ($mm)**	**Share**	Rank
Global Leveraged Loans	$34,166.0	5.9%	6	$22,511.0	4.5%	11	$11,655.00	↑1.4%	↑5
US Leveraged Loans	$16,564.6	6.4%	7	$10,228.0	4.1%	10	$6,336.60	↑2.3%	↑3

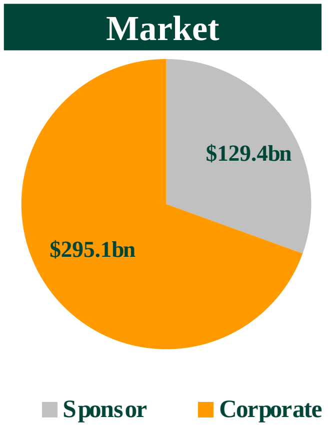
Bonds

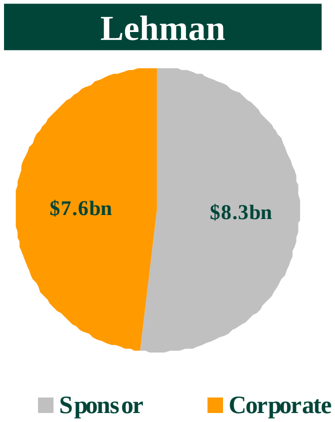
	2007*			2006			Δ		
	Amount ($mm)	**Share**	**Rank**	**Amount ($mm)**	**Share**	**Rank**	**Amount ($mm)**	**Share**	**Rank**
Global HY	$6,157.0	11.0%	4	$3,831.6	7.7%	7	$2,325.40	↑3.3%	↑3
HY US	$6,013.6	13.0%	1	$4,465.7	6.8%	6	$1,547.90	↑6.2%	↑5

*Annualized 2007

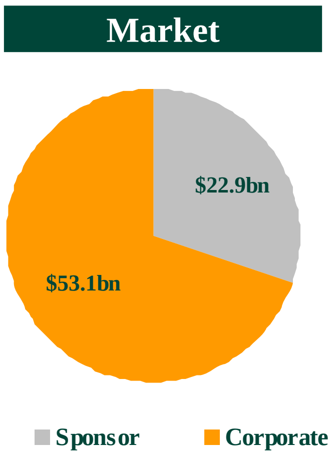
We have been much stronger with Sponsors than Corporates

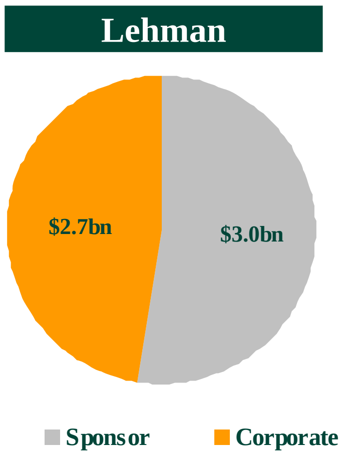
Financial sponsor transactions make up 30% of all U.S. Leveraged loans. It is 52% of Lehman Brothers' business.



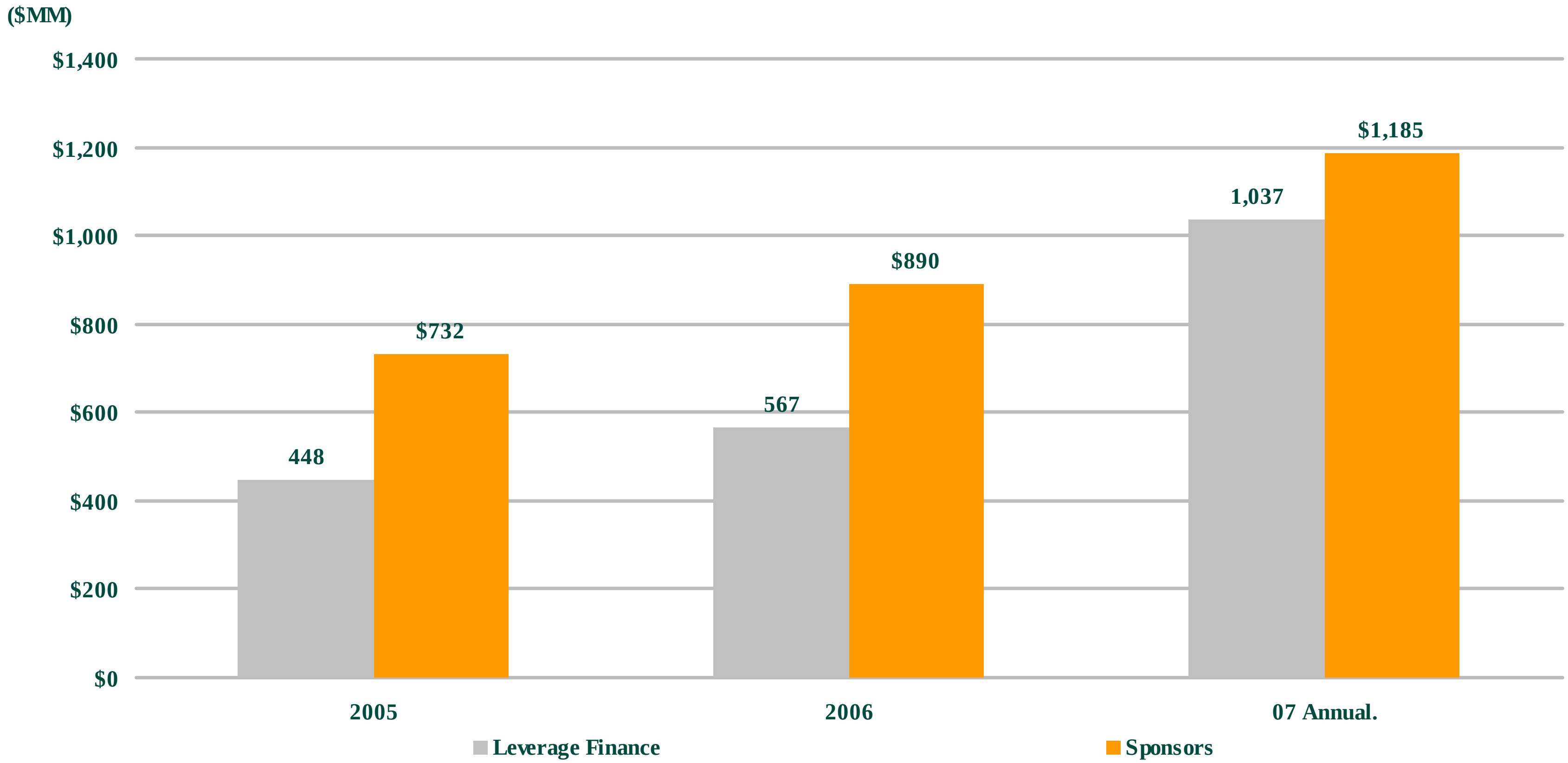


Financial sponsor transactions make up 30% of all U.S. HY Bonds. It is 53% of Lehman Brothers' business.



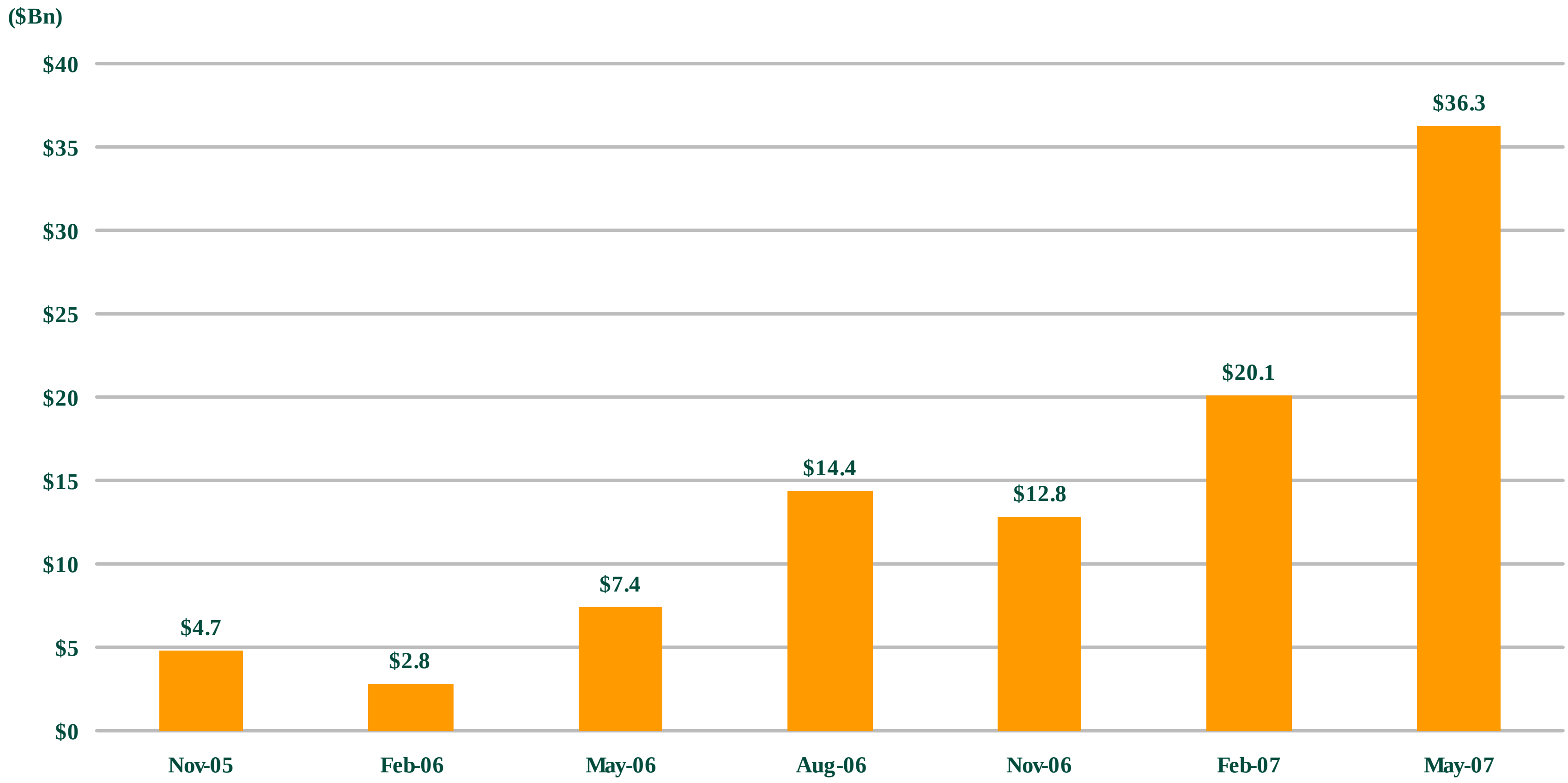


Our Leverage Finance and Financial Sponsor revenues have been growing rapidly



As a consequence, our commitment risk has also grown rapidly

High Yield Contingent Commitments



Stressing the Portfolio

- We used our mandated commitments as of 5/31/07 plus Home Depot Supply (Staple)
- We have estimated the losses under three distinct scenarios.
- Our average cushion on our loan commitments before fees is 70 bps.
- Our average cushion on our bond commitments before fees is 60 bps.
- Our fee pool is $ 579mm.
- Our losses are calculated net of the fees being earned.
- These are not expected cases.
- This does not account for an idiosyncratic loss, just severe market move.
- These are mark to market estimates not expected realized losses.

Fall 2000

US Loans	($80)	(Positive P&L)
US Bridges	$441	
Europe	$22	
Equity	$210	
Mandated Commitments Loss	**$593**	
HY Loan Holds	$78	
Total Loss	**$671**	

Market perceives heightened risk of recession/slow down due to threat of rising interest rates, commodity pricing pressures or growth slow down to point where investors fears EBITDA decline.

Assumptions

US Loans

RC	Current Clearing Spread for TLB + 100bps + 50 to 100 (depending on ABL, rating and other qualitative factors)
TLB	Current Clearing Spread for TLB + 50 (Average, including RC, 65bps)
2d Lien	Current Clearing Spread for 2d liens + 75 to 150 (depending on rating and other qualitative factors)

US Bridges

Senior Debt	Put Bond Cap +150bps (on average)
Sub Debt	Put Bond Cap +275bps (on average)

Europe Loans

Drawn 1L Debt	Current clearing spread +50bps
Undrawn 1L Debt	Current clearing spread +100bps
Second Lien Debt	Current clearing spread +100bps
Mezzanine Debt	11% (except for Lloyds, which is at 12%)

Equity 20% drop

HY Loan Holds

RC	Widening 50-100bps
TL	Widening 50bps

1998

US Loans	$292
US Bridges	$918
Europe	$124
Equity	$347
Mandated Commitments Loss	**$1,680**
HY Loan Holds	$124
Total Loss	**$1,804**

1998 type market due to some sort of external shock or extreme fears causing leverage and liquidity unwind.

Assumptions

US Loans

RC	Current Clearing Spread for TLB + 100 (+) 50 to 250 (depending on rating and other qualitative factors)
TLB	Current Clearing Spread for TLB + 75 to 200 (Average, including RC, 130bps)
2d Lien	Current Clearing Spread for 2d liens + 150-300

US Bridges

Senior Debt	Put Bond Cap +200bps (on average)
Sub Debt	Put Bond Cap +400bps (on average)

Europe Loans

Drawn 1L Debt	Current clearing spread +100bps
Undrawn 1L Debt	Current clearing spread +150bps
Second Lien Debt	6.50%
Mezzanine Debt	12% (except for Lloyds, which is at 13%)

Equity 33% drop

HY Loan Holds

RC	Widening 50-250bps
TL	Widening 75bps-200bps

2002

US Loans	$551
US Bridges	$1,650
Europe	$269
Equity	$525
Mandated Commitments Loss	**$2,995**
HY Loan Holds	$245
Total Loss	**$3,240**

Full blown 2002 recession with EBITDA and multiple contraction. Significant pick-up in defaults.

Assumptions

US Loans

RC	Current Clearing Spread for TLB + 100bps + 150 to 275 (depending on rating and other quantitative factors)
TLB	Current Clearing Spread for TLB + 125-250 (Average, including RC, 170bps)
2d Lien	Current Clearing Spread for 2d liens + 275-450

US Bridges

Senior Debt	Bond price = 82% (on average)
Sub Debt	Bond price = 60% (on average)

Europe Loans

Drawn 1L Debt	Current clearing spread +200bps
Undrawn 1L Debt	Current clearing spread +250bps
Second Lien Debt	8.00%
Mezzanine Debt	13% (except for Lloyds, which is at 14.5%)

Equity 50% drop

HY Loan Holds

RC	Widening 150-275bps
TL	Widening 125-250bps

Possible Solutions

1) Tighten up existing credit standards

Current competitive market has driven standards to new highs not seen since the late 1980's.

- Debt/EBITDA > 8X
- FOF 2007-2008 : Negative to 0
- Average Corp Rating : B3

Structure is skewed towards equity.

- Covenant lite loans
- PIK toggle bonds

Outcome: We will do a lot less business until the market turns.

2) Make strategic decision to limit Bridge Equity

Limits

- Portfolio
- Single Name
- Participation

Outcome: We will limit our participation in large deals.

3) Lower $/Percentage of deals we will underwrite

Outcome: We will not be driving the underwriting , will end up as Jt. Book runner on the Right.

Possible Solutions (cont'd.)

4) Massive macro hedges

Outcome: Uncertain taking on massive basis risk. The options market is not big enough to accommodate.

5) Be more selective on Sponsor/Deals on Economics/Roles

- Focus on deals where we have a leading M&A /Strategic role
- Deemphasize the tag along financing role in auctions
- Focus on fewer sponsors

Outcome: Tough choices for firm around business concentration.

6) Sell risk down through non traditional methods

- Blind pool efforts have failed
- Structured solution has been blocked by Moodys
- Possible silent participation on a name by name basis. Sumitomo is engaged

Outcome: Lower fees and limited ability to execute strategy.

7) Keep firing on all cylinders and continue to increase risk

Outcome: High Beta.