

**LEHMAN BROTHERS**  
**SECOND QUARTER 2008 EARNINGS PRERELEASE**  
**JUNE 16, 2008 @ 10:00 A.M.**  
**DRAFT D**

**ED GRIEB INTRODUCTION**

- THANK YOU FOR JOINING US TODAY FOR OUR SECOND 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. 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 AND MOST RECENT QUARTERLY REPORT ON FORM 10-Q, AS FILED WITH THE SEC.

- THIS PRESENTATION CONTAINS CERTAIN NON-GAAP FINANCIAL MEASURES. INFORMATION RELATING TO THESE FINANCIAL MEASURES CAN BE FOUND UNDER THE FOOTNOTES 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).

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Do we need the above bullet if we are going to change the use of Revenue run rate?? I

assume we are going to take out the page in the press release supplement.

- [REFERENCE TO TRANSCRIPT – CHECKING WITH LEGAL]
- NOW, I WOULD LIKE TO TURN THE CALL OVER TO [ ]

**IAN LOWITT REMARKS BEGIN**

- GOOD MORNING AND THANK YOU FOR JOINING US TODAY
- ON LAST MONDAY'S CALL, WE PREVIEWED WITH YOU THE PERFORMANCE OF OUR FRANCHISE DURING THE QUARTER
- WE ARE OBVIOUSLY EXTREMELY DISAPPOINTED WITH THESE RESULTS AND DO NOT BELIEVE THEY ARE INDICATIVE OF THE ONGOING EARNINGS POWER OF OUR BUSINESS
- THAT SAID, THEY CLEARLY RAISE A NUMBER OF IMPORTANT QUESTIONS ON BEHALF OF INVESTORS, AND SO WE WANT TO SPEND TIME WITH YOU THIS MORNING GOING THROUGH OUR EARNINGS AND PROVIDING ADDITIONAL INFORMATION

• As I stated our recent performance has been disappointing to us, our shareholders and the investing public at large. We understand that our results have raised concerns about the strength of our business both in the short and longterm, which we will address in detail today.

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• WE WillSTART THE PROCESS OF RE-BUILDING YOUR CONFIDENCE IN US BY BEING AS TRANSPARENT AS POSSIBLE, PRESENTING YOU WITH A GREATER LEVEL OF DISCLOSURE, AND TALKING FREELY ABOUT OUR SPECIFIC PLANS GOING FORWARD

- IN DOING SO, THERE ARE REALLY FIVE OR SIX MAIN TOPICS WE'D LIKE TO FOCUS ON
- FIRST, WE WANT TO TALK ABOUT THE SPECIFIC SET OF FACTORS WHICH DROVE OUR RESULTS FOR THE QUARTER SO THAT YOU CAN UNDERSTAND WHAT HAPPENED, WHY IT HAPPENED AND WHAT WE ARE DOING TO ENSURE THAT IT DOES NOT HAPPEN AGAIN
- SECOND, WE WANT TO TALK A LITTLE ABOUT THE STATE OF OUR CLIENT FRANCHISE, WHICH REMAINS SOLID, DESPITE THE CURRENT ENVIRONMENT
- THIRD, WE WANT TO TALK ABOUT THE STEPS WE'VE TAKEN DURING THE QUARTER TO ACHIEVE THE KIND OF DE-LEVERAGING WE REPORTED LAST WEEK, AND SPECIFICALLY TALK ABOUT THE KIND OF ASSETS WE SOLD SO THAT YOU CAN HAVE A CLEARER UNDERSTANDING OF OUR REMAINING POSITIONS
- AS PART OF THIS DISCUSSION, WE WANT TO SPEND A SIGNIFICANT AMOUNT OF TIME discussing our asset valuation process and our current balance sheet exposures. <this sentence makes it seem like the sale of assets gave us information to remark our book, which I

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am sure it did, but I am concerned it will be misinterpreted to mean you had positions priced incorrectly before>

- FOURTH, WE WANT TOUCH ON OUR LIQUIDITY POSITION AND GIVE YOU SOME SENSE FOR HOW THAT HAS EVOLVED OVER THE LAST QUARTER AND ALSO OVER THE PAST WEEK
- FIFTH, WE WANT TO TALK ABOUT OUR OVERALL APPROACH TO RISK MANAGEMENT. MANY OF YOU HAVE BEEN ASKING HOW WE CAN RECONCILE OUR RECENT PERFORMANCE WITH OUR HISTORICALLY STRONG RISK MANAGEMENT PRACTICES, SO I WANT TO GO THROUGH THIS IN SOME DETAIL
- AND FINALLY, WE WANT TO TALK ABOUT OUR BUSINESS MODEL GOING FORWARD. A NUMBER OF YOU HAVE RAISED QUESTIONS ABOUT OUR ABILITY TO GENERATE REASONABLE RETURNS IN A LESS LEVERAGED ENVIRONMENT, SO WE WANT TO SPEND A FEW MINUTES TALKING ABOUT HOW WE SEE OUR ECONOMICS ON A GO FORWARD BASIS
- SO LET ME GET STARTED

#### **SECOND QUARTER PERFORMANCE**

- AS DISCUSSED ON OUR CALL LAST MONDAY, THIS QUARTER WE POSTED OUR FIRST QUARTERLY LOSS AS A PUBLIC COMPANY
- WE REPORTED NET REVENUES OF NEGATIVE \$700 MILLION, A NET LOSS OF \$2.8 BILLION AND DILUTED LOSS PER SHARE OF \$5.14
- THE MARKETS WERE UNIQUELY IMPACTED THIS QUARTER BY A SIGNIFICANT DISLOCATION IN SPREAD MOVEMENTS AMONG DERIVATIVE INDICES AND THE UNDERLYING CASH ASSETS

- [MORE DETAIL] <I AGREE MORE INFO WOULD BE GOOD>

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- THIS, COMPOUNDED OUR GROSS MARK-TO-MARKET ADJUSTMENTS OF \$3.6 BILLION BY REDUCING THE EFFECTIVENESS OF HEDGES AGAINST OUR LESS LIQUID ASSETS – INCLUDING RESIDENTIAL MORTGAGES, COMMERCIAL MORTGAGES AND ACQUISITION FINANCE <I DO BELIEVE THE WORLD IS CONFUSED ON THE WORD “HEDGE”, I THINK THEY EXPECT IT MEANS AN EQUAL AND OFFSETTING AMOUNT WILL RESULT AT ALL TIMES, SO THEY ARE CONFUSED ON HOW YOU CAN LOSE ON HEDGES ANY CLARIFICATION WOULD BE GREAT>

- ON AN AGGREGATE BASIS, WE INCURRED A NET LOSS OF \$100 MILLION ON OUR HEDGES AGAINST THESE ASSETS THIS QUARTER, FOR NET MARK-TO-MARKET ADJUSTMENTS RELATED TO THESE ASSET CLASSES APPROXIMATELY OF \$3.7 BILLION

- OUR PRINCIPAL AND PRIVATE EQUITY PORTFOLIOS ALSO INCURRED LOSSES OF APPROXIMATELY \$500 MILLION THIS QUARTER, INCLUDING \$300 MILLION RECORDED IN EQUITIES, CAPITAL MARKETS AND \$200 MILLION IN FIXED INCOME

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- AND WE HAD APPROXIMATELY \$700 MILLION OF LOSSES ASSOCIATED WITH CERTAIN LARGE POSITIONS IN OUR CREDIT AND RATES BUSINESSES

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- OUR CREDIT BUSINESS WAS POSITIONED BROADLY SHORT CREDIT DURING MARCH AND PARTS OF APRIL

- IN APRIL WE SAW HUGE DEMAND FROM OUR CLIENT BASE TO SELL PROTECTION ON HIGH GRADE NAMES, AS THE IG INDEX RALLIED NEARLY 100BP IN A WEEK
- MEETING THIS CLIENT DEMAND MADE REDUCING OUR SHORT MORE DIFFICULT AND RESULTED IN LOSSES ON OUR SHORT POSITIONS AS SPREADS TIGHTENED.

- ALSO, OUR RATES BUSINESS WAS POSITIONED LONG GLOBAL INTEREST RATES IN APRIL, AND LIBOR BASIS WIDENING RESULTED IN ADDITIONAL LOSSES.

- <NOT SURE THE ABOVE SERVES ANY PURPOSE>

- THESE LOSSES COMBINED WITH THE MTM ADJUSTMENTS MENTIONED ABOVE, NEGATIVELY IMPACTED OUR REVENUES BY A TOTAL OF APPROXIMATELY \$4.9 BILLION

- THE \$4.9 BILLION IN LOSSES, COMPARED TO, THE TOTAL \$700 MILLION OF NEGATIVE REPORTED REVENUES, MEANS THE REST OF THE FIRM PRODUCED, REVENUES OF APPROXIMATELY \$4.2 BILLION

- WHICH WE BELIEVE, ARE MORE INDICATIVE OF THE UNDERLYING EARNINGS POWER OF THE FRANCHISE, AND WERE EARNED IN A VERY CHALLENGING AND EVENTFUL MARKET

- WITH RESPECT TO EXPENSES – FOR THE QUARTER, OUR TOTAL COMPENSATION EXPENSE WAS \$2.3 BILLION, A \$480 MILLION INCREASE FROM LAST QUARTER

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WHILE WE DO NOT ENGAGE IN LARGE MACRO HEDGING ON A DIVISION WIDE LEVEL, THE PRIMARY FOCUS OF OUR CLIENT BUSINESS IS TO MAINTAIN OUR MARKET SHARE EVEN IN VERY CHALLENGING MARKET CONDITIONS AS WE SAW THIS QUARTER

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- WE REMAIN COMMITTED TO COMPENSATING OUR EMPLOYEES COMPETITIVELY TO MAINTAIN THE MOMENTUM IN OUR CLIENT FRANCHISE
- DURING THE QUARTER, WE INCURRED SEVERANCE COSTS OF APPROXIMATELY \$140 MILLION THAT WERE INCLUDED IN COMPENSATION EXPENSE. NO NEED FOR THIS
- OUR HEADCOUNT DECLINED BY 1,900, MOST NOTABLY IN THE U.S., AS WE CONTINUE TO SCALE OUR BUSINESSES TO THE RESPECTIVE OPPORTUNITIES
  - HEADCOUNT CHANGES ACROSS THE FIRM REFLECT A CHANGING MARKETPLACE, IN WHICH WE HAVE EXITED CERTAIN BUSINESSES IN SECULAR DECLINE (SUCH AS MORTGAGE ORIGINATION), WHILE MODESTLY RESCALING IN AREAS OF TEMPORARY CYCLICAL DOWNTURN
- OUR NON-PERSONNEL EXPENSES TOTALED \$1.1 BILLION FOR THE QUARTER
  - IN THIS AREA, WE'VE IMPLEMENTED A NUMBER OF FURTHER COST SAVING INITIATIVES THIS QUARTER, WHICH WE EXPECT WILL GENERATE APPROXIMATELY \$250 MILLION IN ANNUALIZED SAVINGS GOING FORWARD
  - DURING THE QUARTER, WE HAD ADDITIONAL COSTS OF APPROXIMATELY \$20 MILLION ASSOCIATED WITH THE PREVIOUSLY

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ANNOUNCED CLOSINGS OF OUR MORTGAGE CAPITAL LOCATIONS,  
MOSTLY RELATED TO TECHNOLOGY COSTS

- THE INCREASE IN OTHER EXPENSES THIS QUARTER WAS LARGELY  
DRIVEN BY DEPRECIATION EXPENSE ON REAL ESTATE INVESTMENTS  
HELD FOR SALE THAT WE'VE HELD FOR GREATER THAN A YEAR, AS  
UNDER THE ACCOUNTING RULES WE MUST NOW START  
DEPRECIATING THESE ASSETS <DO WE REALLY NEED THIS IT MAY  
RESULT IN MANY QUESTIONS. IF WE KEEP IT IAN NEEDS TO BE  
PREPPED TO ANSWER MANY SPECIFIC ACCOUNTING QUESTIONS. MY  
SENSE IS CAN IT>

### CLIENT FRANCHISE

- I NOW WANT TO TAKE A MINUTE TO TALK ABOUT THE STATE OF OUR  
CLIENT FRANCHISE, SINCE THIS FRANCHISE IS WHAT DROVE \$4.2 BILLION  
OF REVENUES, before the losses and MTM adjustments mentioned earlier, FOR THE  
QUARTER AND ACCOUNTS FOR THE MAJORITY OF THE FIRM'S EARNINGS  
POWER OVER TIME
- AS YOU KNOW, WE HAVE A STRONG, CLIENT FOCUSED STRATEGY – THE  
KEY TO WHICH IS PROVIDING INTELLECTUAL CAPITAL TO OUR  
CORPORATE, INSTITUTIONAL AND HIGH NET WORTH CLIENTS
- THIS FRANCHISE HAS REMAINED SOLID THROUGHOUT THE QUARTER

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- IN INVESTMENT BANKING, WE POSTED REVENUES OF \$858 MILLION, ESSENTIALLY FLAT VERSUS THE SEQUENTIAL PERIOD AND DOWN 25% YEAR-OVER-YEAR
  - YEAR-TO-DATE, WE CONTINUE TO GAIN FEE SHARE IN BANKING, FROM 4.4% IN 2007 TO 4.8% THIS YEAR
- CLEARLY THE DOMINANT THEME FOR THE QUARTER WAS CAPITAL RAISING IN THE FINANCIAL SECTOR
  - U.S. FINANCIALS RAISED A TOTAL OF \$150 BILLION OF CAPITAL (INCLUDING EQUITY AND HYBRID CAPITAL) IN THE FIRST FIVE MONTHS OF 2008 (EXCLUDING TRADITIONAL DEBT AND SELF-ISSUED DEALS)
  - WE LEAD-MANAGED 37% OF THIS VOLUME, INCLUDING \$4.8 BILLION OF NEW CAPITAL FOR FNMA, \$7.0 BILLION FOR WASHINGTON MUTUAL AND \$1.5 BILLION FOR CIT
- IN EQUITY ORIGINATION, OUR REVENUES TOTALED \$330 MILLION, UP 54% FROM LAST QUARTER AND FLAT VERSUS THE YEAR AGO PERIOD
  - GLOBALLY, WE HAVE GROWN OUR EQUITY MARKET SHARE TO 5.8% THIS YEAR FROM 3.6% IN 2007, AND WE ARE #3 YEAR-TO-DATE IN U.S. FOLLOW-ONS WITH 12.4% MARKET SHARE (UP FROM 7.8% IN 2007)
- FIXED INCOME ORIGINATION REVENUES WERE \$288 MILLION, DOWN 11% SEQUENTIALLY AND 47% VERSUS THE YEAR AGO PERIOD

- YEAR-TO-DATE WE HAVE MADE MODEST MARKET SHARE GAINS IN HIGH GRADE ISSUANCE, WITH 4.2% OF THE GLOBAL MARKET VS. 4.0% LAST YEAR; WE ARE CURRENTLY RANKED #4 IN U.S. ISSUANCE WITH AN 8.5% SHARE
- WE LEAD-MANAGED THE TWO LARGEST MARQUEE TRANSACTIONS OF THE QUARTER – \$9 BILLION FOR GLAXOSMITHKLINE AND \$8.5 BILLION FOR GECC
- OUR M&A ADVISORY REVENUES WERE \$240 MILLION, DOWN 27% SEQUENTIALLY AND 13% VERSUS THE YEAR AGO PERIOD
  - GLOBALLY, WE HAVE IMPROVED OUR MARKET SHARE SINCE THE BEGINNING OF THE YEAR – GROWING OUR SHARE OF COMPLETED DEALS TO 24.4% THIS YEAR FROM 19.4% IN 2007
  - WE CURRENTLY RANK #4 IN THE U.S. AND #1 IN ASIA (EX-JAPAN) IN ANNOUNCED M&A
  - AS OF THE SECOND QUARTER, WE HAVE ADVISED ON 3 OF THE TOP 4 COMPLETED DEALS AND 3 OF THE TOP 10 ANNOUNCED M&A TRANSACTIONS OF THE YEAR
  - SOME OF OUR LARGE ASSIGNMENTS IN THE 2<sup>ND</sup> QUARTER INCLUDE:
    - HP'S ACQUISITION OF EDS
    - SPRINT NEXTEL'S JOINT VENTURE WITH CLEARWIRE
    - LIBERTY MUTUAL'S ACQUISITION OF SAFECO; AND
    - FINMECCANICA'S ACQUISITION OF U.S. DEFENSE COMPANY DRS

- WE ALSO CLOSED THE PHILIP MORRIS INTERNATIONAL SPIN-OFF AND CARLSBERG'S ACQUISITION OF SCOTTISH & NEWCASTLE, AND DEFENDED YAHOO AGAINST A HOSTILE BID FROM MICROSOFT
- TOGETHER, THESE MARKET SHARE GAINS AND MARQUEE ASSIGNMENTS ARE POWERFUL EVIDENCE OF THE STRENGTH AND DIVERSITY OF OUR BANKING FRANCHISE
- SIMILARLY, OUR INVESTMENT MANAGEMENT BUSINESS CONTINUES TO SHOW IMPRESSIVE GROWTH
- THIS BUSINESS IS COMPRISED OF TWO SEGMENTS:
  - ASSET MANAGEMENT, WHICH PRIMARILY REPRESENTS OUR NEUBERGER BERMAN BUSINESS; AND
  - PRIVATE INVESTMENT MANAGEMENT, WHICH INCLUDES OUR HIGH NET WORTH BROKER BUSINESS
- WE GENERATED INVESTMENT MANAGEMENT REVENUES OF APPROXIMATELY \$848 MILLION THIS QUARTER, DOWN 12% SEQUENTIALLY AND 10% HIGHER THAN THE SECOND QUARTER OF 2007
  - THE SEQUENTIAL REVENUE DECLINE THIS QUARTER WAS PRIMARILY DRIVEN BY A SEASONAL INCREASE IN FIRST QUARTER INCENTIVE FEES AND REVENUES FROM OUR MINORITY INVESTMENTS IN 3<sup>RD</sup> PARTY ALTERNATIVE MANAGERS

- PRIVATE INVESTMENT MANAGEMENT GENERATED RECORD REVENUES THIS QUARTER
- OUR ASSETS UNDER MANAGEMENT BALANCES WERE FLAT THIS QUARTER AT \$277 BILLION, AS NET OUTFLOWS WERE OFFSET BY MARKET APPRECIATION
  - THESE NET OUTFLOWS WERE PRIMARILY IN MONEY MARKET ASSETS; WE ADDED NEARLY \$4 BILLION IN ALTERNATIVES
- THE PRE-TAX OPERATING INCOME FOR THE DIVISION THIS QUARTER WAS \$229 MILLION, REPRESENTING A PRE-TAX MARGIN OF 27 %
- WE HAVE BEEN GROWING THE REVENUES AND MARGIN IN THIS BUSINESS AS PART OF OUR DIVERSIFICATION AND GROWTH STRATEGY
  - TO GIVE YOU A SENSE OF THE RATE OF GROWTH – FROM 2004 THROUGH 2007, OUR REVENUES AND AUM GREW AT COMPOUNDED ANNUAL GROWTH RATES OF 22% AND 27%, RESPECTIVELY
  - AND PRIVATE EQUITY AUM HAS GROWN OVER 40% IN THE PAST 12 MONTHS
  - NEW MANDATES WITH FORD, TEXAS TEACHERS, AND FLORIDA PENSION FURTHER VALIDATE OUR ABILITY TO ATTRACT NEW ASSETS
  - OUR INVESTMENT PERFORMANCE CONTINUES TO BE TOP-NOTCH WITH OVER 95% OF HIGH NET WORTH AUM EXCEEDING BENCHMARKS OVER A 5 YEAR BASIS

- WE HAVE A ROBUST PIPELINE OF NEW PROJECTS WITH OFFERINGS IN CHINA AND ASIA LONG / SHORT FUNDS, OUR GLOBAL CLIMATE CHANGE FUND, AND AN INFRASTRUCTURE FUND, AMONG OTHERS
- AND WE'VE ONLY JUST STARTED EXPANDING IN EUROPE AND ASIA
- FROM A VALUATION PERSPECTIVE, ASSUMING A MARKET VALUE TO AUM RATIO OF APPROXIMATELY 3%, THIS WOULD IMPLY AN OVERALL VALUE OF APPROXIMATELY \$8 BILLION TO ASSET MANAGEMENT ALONE, AND OUR BASIS IN NEUBERGER BERMAN FROM THE 2003 ACQUISITION IS ONLY \$3 BILLION
- MOVING TO OUR CAPITAL MARKETS SEGMENT, WE POSTED REVENUES OF NEGATIVE \$2.4 BILLION, COMPARED WITH \$1.7 BILLION IN THE SEQUENTIAL PERIOD, AND \$3.6 BILLION IN THE SECOND QUARTER OF LAST YEAR
- WHILE THESE RESULTS WERE SIGNIFICANTLY IMPACTED BY THE MARK-TO-MARKET ADJUSTMENTS AND OTHER LOSSES OF \$4.9 BILLION I NOTED EARLIER, OUR CLIENT-FACING REVENUE ACTIVITY (AS MEASURED BY OUR SALES CREDITS) REMAINED SOLID
- CLIENT REVENUES FOR THE FIRST SIX MONTHS OF 2008 WERE UP 30% VERSUS THE FIRST HALF OF 2007
- IN THE SECOND QUARTER, CLIENT REVENUES WERE DOWN ONLY 3% FROM A STRONG FIRST QUARTER AND UP 14% OVER LAST YEAR

- IN FIXED INCOME, CLIENT REVENUES FOR THE FIRST HALF OF 2008 GREW 40% OVER LAST YEAR, INCLUDING GROWTH OF OVER 35% IN EACH OF OUR REGIONS – THE AMERICAS, EUROPE AND ASIA
- THIS QUARTER, CLIENT REVENUES WERE DOWN ONLY 2% FROM THE FIRST QUARTER AND UP 27% VERSUS LAST YEAR
- WE SAW STRONG SECONDARY FLOWS IN SECURITIZED PRODUCTS, MUNICIPALS, COMMODITIES, FOREIGN EXCHANGE, HIGH GRADE CREDIT, INTEREST RATES AND FINANCING, WHICH ARE ALL UP SIGNIFICANTLY VERSUS YEAR AGO
- WITHIN EQUITIES CAPITAL MARKETS, CLIENT REVENUES WERE UP 16% FOR THE FIRST HALF OF THE YEAR, INCLUDING GROWTH OF APPROXIMATELY 10% OR MORE ACROSS EACH OF OUR REGIONS
- THIS QUARTER, CLIENT REVENUES WERE DOWN APPROXIMATELY 3% VERSUS BOTH COMPARABLE PERIODS
- WE SAW STRONG CLIENT REVENUE GROWTH THIS YEAR ACROSS BOTH EXECUTION SERVICES AND OUR PRIME BROKER BUSINESS, THE LATTER OF WHICH GENERATED [RECORD] CLIENT REVENUES IN THE SECOND QUARTER
- IN SUMMARY, THE LEVEL OF CLIENT ACTIVITY ACROSS BUSINESSES, PRODUCTS AND REGIONS IS SOLID AND GROWING – AND THIS IS INDICATIVE OF THE UNDERLYING VALUE OF OUR FRANCHISE

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### **LEVERAGE AND EXPOSURES**

- WHILE CONTINUING MOMENTUM IN OUR CLIENT FRANCHISE, WE ALSO DELIVERED ON OUR PLANS TO REDUCE OUR LEVERAGE AND EXPOSURE POSITIONS DURING THE QUARTER
- DELEVERAGING AND DE-RISKING THE BALANCE SHEET WAS AN IMPORTANT GOAL THIS QUARTER, AS WE RECOGNIZED THE CRITICAL NEED TO REDUCE CONCENTRATED EXPOSURE TO LESS LIQUID ASSETS, INCREASE OUR OPERATING FLEXIBILITY IN A DIFFICULT ENVIRONMENT AND REDEPLOY CAPITAL TO CLIENT-FACING ACTIVITIES
- PRIOR TO THE IMPACT OF LAST WEEK’S CAPITAL RAISE:
  - WE REDUCED OUR GROSS LEVERAGE FROM 31.7 TIMES TO 24.3 TIMES AT MAY 31<sup>ST</sup>, AND WE REDUCED NET LEVERAGE FROM 15.4 TIMES TO 12.0 TIMES
  - THIS DELEVERAGING WAS LARGELY DRIVEN BY A SIGNIFICANT REDUCTION IN ASSETS – INCLUDING LESS LIQUID EXPOSURES IN RESIDENTIAL AND COMMERCIAL MORTGAGES, REAL ESTATE HELD FOR SALE AND ACQUISITION FINANCE
- PLEASE REFER TO PAGE [ ] IN THE PRESS RELEASE DETAILING OUR CURRENT ASSET EXPOSURES
- RESIDENTIAL MORTGAGE ASSETS, ~~<OTHERWISE SOUNDS LIKE WHOLE LOANS ONLY>~~ DECLINED TO \$24.9 BILLION THIS QUARTER FROM \$31.8 BILLION IN THE FIRST QUARTER, A DECLINE OF \$6.9 BILLION OR 22%
  - THIS INCLUDES \$11.7 BILLION OF ASSET SALES

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- GROSS WRITEDOWNS DECLINED 20% FROM THE FIRST QUARTER TO \$[2.4] BILLION THIS QUARTER
- THESE WRITEDOWNS WERE OFFSET BY \$400 MILLION OF HEDGING GAINS, CLEARLY LESS BENEFICIAL THAN IN PRIOR QUARTERS, GIVEN THE BASIS DISLOCATION BETWEEN CASH AND OUR DERIVATIVES; SO NET MARK-TO-MARKET ADJUSTMENTS WERE \$2 BILLION
- WITHIN RESIDENTIAL, ALT-A ASSETS DECLINED BY 29% TO \$10.3 BILLION FROM \$14.6 BILLION
  - ALT-A ASSETS ARE COMPRISED OF \$5.4 BILLION OF SECURITIES, \$2.1 BILLION OF WHOLE LOANS, AND \$[ ] BILLION OF SERVICING AND RESIDUALS
  - I'LL DISCUSS PRICING ON THE ASSETS LATER ON THE CALL
- EUROPEAN RESIDENTIAL ASSETS DECLINED MODESTLY TO \$9.1 BILLION THIS QUARTER FROM \$9.5 BILLION IN THE FIRST QUARTER
- SUBPRIME ASSETS DECLINED BY [33]% TO \$[2.7] BILLION FROM \$[ ] BILLION
- AND ABS CDO ASSETS DECLINED [33]% TO \$[600] MILLION THIS QUARTER FROM \$900 MILLION IN THE FIRST QUARTER
- COMMERCIAL MORTGAGES ASSETS DECLINED TO \$29.9 BILLION THIS QUARTER FROM \$36.1 BILLION IN THE FIRST QUARTER, A DECLINE OF \$6.2 BILLION OR OVER 17%
  - THIS INCLUDES \$7 BILLION OF ASSET SALES

- GROSS WRITEDOWNS DECLINED OVER 35% FROM THE FIRST QUARTER TO \$700 MILLION
- NOT SURE WHAT WE ARE TRYING TO SAY, WRITEDOWNS ON COMMERCIAL ASSETS WERE \$1.1 BILLION AND INCLUDE \$400 MILLION HEDGING LOSSES THIS QUARTER. <IT WOULD HELP TO EXPLAIN THIS LOSS. IT WOULD SHOW THAT THE “HEDGES” ARE REALLY RISK MITIGATION STRATEGIES THAT WENT AGAINST THE FIRM>
- COMMERCIAL WRITEDOWNS INCLUDED A \$350 MILLION MARK ON OUR ARCHSTONE POSITION.
- THE \$[7] BILLION OF COMMERCIAL MORTGAGE ASSETS SOLD THIS QUARTER WERE ACROSS THE CAPITAL STRUCTURE, TO OVER 170 DIFFERENT CLIENT ACCOUNTS, AND MORE THAN 75% WERE OUTRIGHT SALES WITHOUT SELLER FINANCING
- TO GIVE A SENSE THAT WE LIQUIDATED MANY TYPES OF ASSETS, AND NOT JUST THE MOST LIQUID:
  - REGIONALLY, WE REDUCED ASSETS BY [25]% IN THE U.S., [19]% IN EUROPE AND [11]% IN ASIA
  - BY ASSET TYPE, WE REDUCED WHOLE LOANS BY \$[5.5] BILLION, OR [22]%, AND SECURITIES BY \$[1.6] BILLION, OR [14]%

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- WHOLE LOANS SOLD INCLUDED [ ]% OF MEZZANINE LOANS AND LOWER AND [ ]% OF 1<sup>ST</sup> LIEN; [ ]% WERE FLOATING RATE AND [ ]% FIXED
- IN APRIL WE SECURITIZED AND SOLD \$500 MILLION OF LOANS
- SECURITIES SOLD INCLUDED [ ]% OF AA OR BETTER
- REGARDING REAL ESTATE OWNED – THESE ASSETS DECLINED TO \$[10.4] BILLION THIS QUARTER FROM \$12.9 BILLION IN THE FIRST QUARTER, A DECLINE OF \$[2.5] BILLION OR [19]%
  - THIS INCLUDES \$[ ] BILLION OF ASSET SALES
  - THESE INVESTMENTS INCLUDE COMMERCIAL REAL ESTATE WHERE LEHMAN BROTHERS IS DEEMED TO HAVE A CONTROLLING INTEREST IN THE UNDERLYING PROPERTY
  - UNLIKE OUR FINANCIAL ASSETS, REAL ESTATE IS VALUED AT LOWER OF COST OR MARKET UNDER FAS 144 – OR IN OTHER WORDS, WE WILL TAKE MARKDOWNS ON THESE POSITIONS BUT DO NOT RECOGNIZE UNREALIZED GAINS ON THE INVESTMENTS
- ACROSS COMMERCIAL MORTGAGE ASSETS AND REAL ESTATE HELD FOR SALE, WE HAVE AGGREGATE EXPOSURE OF APPROXIMATELY \$40 BILLION, WHICH WE BELIEVE IS STILL TOO CONCENTRATED IN PROPORTION TO OUR CAPITAL BASE
- WE PLAN TO BRING THIS BALANCE DOWN BY A TARGET OF 20% BY THE END OF THE YEAR, WITH FURTHER REDUCTIONS THEREAFTER

- HOWEVER, OUR INTENT IS TO PURSUE THESE SALES IN A MEASURED WAY, WHILE PRESERVING VALUE FOR OUR SHAREHOLDERS
- I'LL GIVE MORE DETAIL ON THE COMPOSITION OF OUR REMAINING RESIDENTIAL AND COMMERCIAL EXPOSURES WHEN I DISCUSS VALUATION OF THESE ASSETS LATER ON THE CALL
- WITH RESPECT TO OTHER NON-MORTGAGE ASSET-BACKED SECURITIES, THESE ASSETS [REMAINED FLAT AT] \$[6.5] BILLION THIS QUARTER
  - THIS INCLUDES \$750 MILLION OF ASSET SALES
  - THESE ASSETS ARE SECURITIZED ASSET-BACKED ISSUANCES, AS WELL AS SOME WHOLE LOANS, AND THERE ARE A VARIETY OF DIFFERENT DEBT INSTRUMENTS,
    - FRANCHISE-RELATED WHOLE BUSINESS FINANCINGS OF \$[ ] BILLION (INCLUDING \$[ ] BILLION RELATED TO IHOP'S ACQUISITION OF APPLEBEE'S)
    - STUDENT LOANS OF \$[ ] BILLION
    - SMALL BUSINESS LOANS OF \$[ ] BILLION
    - AUTO LOANS OF \$[ ] BILLION
    - CREDIT CARDS OF \$[ ] BILLION, AND
    - OTHER LOANS OF \$[ ] BILLION
  - WITH RESPECT TO THE APPLEBEE'S ASSET, THIS POSITION IS INVESTMENT GRADE RATED, AND WE SOLD \$[ ] MILLION DURING

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THE QUARTER AND AN ADDITIONAL \$[ ] MILLION AFTER QUARTER-  
END

- IN TOTAL, APPROXIMATELY [ ]% OF THE BOOK IS NOW INVESTMENT  
GRADE RATED, AND MOST POSITIONS WERE CATEGORIZED AS LEVEL  
II ASSETS IN THE FIRST QUARTER [COMMENT ON THIS QUARTER?]

• WITH REGARD TO ACQUISITION FINANCE FACILITIES, OUR TOTAL  
EXPOSURE DECLINED TO \$[18.0] BILLION THIS QUARTER FROM \$28.7  
BILLION IN THE FIRST QUARTER, A DECLINE OF \$[10.7] BILLION OR [37]%

- INVESTMENT GRADE EXPOSURE DECLINED BY [41]% TO \$[6.4]  
BILLION, DRIVEN BY \$[ ] BILLION OF SALES, \$[ ] BILLION OF  
COMMITMENTS ROLLING OFF, \$[ ] BILLION OF GROSS WRITEDOWNS,  
AND \$[ ] BILLION OF ADDITIONS

▪ OF THE FUNDED LOANS, APPROXIMATELY \$[ ] WAS  
SUBSEQUENTLY REPAID LAST WEEK THROUGH RIGHTS  
OFFERINGS FOR IMPERIAL TOBACCO AND CARLSBERG

- NON-INVESTMENT GRADE EXPOSURE DECLINED BY [35]% TO \$[11.6]  
BILLION, DRIVEN BY \$[ ] BILLION OF SALES, \$[ ] BILLION OF  
COMMITMENTS ROLLING OFF, \$[ ] BILLION OF GROSS WRITEDOWNS,  
AND \$[ ] BILLION OF ADDITIONS

### **ASSET MARKS AND VALUATION**

• NOW I WOULD LIKE TO DISCUSS OUR ASSET VALUATIONS IN MORE  
DETAIL

- OUR GOAL IS TO PROVIDE MORE DISCLOSURE ON OUR VALUATION PROCESS, THE COMPOSITION OF OUR EXPOSURES IN ORDER TO PROVIDE A GREATER DEGREE OF TRANSPARENCY AND COMFORT AROUND OUR POSITIONS

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- AS PART OF OUR CONTROL PROCESS, WE HAVE AN INDEPENDENT VALUATION GROUP WITHIN FINANCE TO ENSURE THAT THE POSITIONS ARE VALUED appropriately.

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- THE TEAM CONSISTS OF APPROXIMATELY 100 STAFF GLOBALLY, WHO VERIFY PRICING THROUGH A NUMBER OF MEANS, INCLUDING:
  - REVIEW OF RECENT SALES ACTIVITY FOR THAT OR SIMILAR ASSETS
  - COMPARISON TO PRICES FROM EXTERNAL DATA PROVIDERS
  - COMPARISON TO EXTERNAL CONSENSUS DATA PROVIDERS, WHICH COLLATE DATA FROM OTHER MARKET PARTICIPANTS AND PUBLISH AVERAGE PRICES
  - REVIEW OF BROKER QUOTES FOR THAT OR SIMILAR ASSETS
  - REVIEW OF INDEX LEVELS FOR CERTAIN ASSET CLASSES (FOR EXAMPLE, THE ABX INDEX), TAKING INTO ACCOUNT ANY BASIS RISK THAT MAY EXIST BETWEEN CASH AND SYNTHETIC POSITIONS, AND
  - REVIEW OF INTERNAL AND THIRD PARTY RESEARCH REPORTS

<I THOUGHT THE ABOVE WAS VERY WELL DONE>

- ALTHOUGH CERTAIN SECTIONS OF THE MARKETS ARE CURRENTLY DISTRESSED, THERE HAS BEEN RECENT SALES ACTIVITY IN MANY ASSET CLASSES, ALLOWING THE GROUP TO BENCHMARK TO THESE PRICES
- IN ADDITION TO THE VALUATIONS GROUP, THERE ARE APPROXIMATELY 500 FINANCE PROFESSIONALS DEDICATED TO THE PRODUCTION AND ANALYSIS OF DAILY PROFIT AND LOSS REPORTS AND TO THE EXPLANATIONS FOR THE PROFIT OR LOSS, GIVEN AN ASSET'S RISK PROFILE AND MARKET MOVEMENTS
- WE ARE COMFORTABLE THAT THE FLOWS WE'VE SEEN OVER THE PAST QUARTER HAVE GIVEN US GOOD TRANSPARENCY IN THE MARKS WE HAVE AGAINST OUR REMAINING POSITIONS
  - ACROSS THE RESIDENTIAL AND COMMERCIAL BOOKS, WE SOLD AN AGGREGATE OF \$[ ] BILLION OF ASSETS DURING THE QUARTER
  - OUR REALIZED LOSSES ON THESE SALES WERE \$300 MILLION FOR RESIDENTIAL SALES AND \$125 MILLION FOR COMMERCIAL, GIVING US COMFORT ON THE VALUATION PROCESS OVERALL AND OUR MARKS AS OF LAST QUARTER
- FOR RESIDENTIAL:
  - THE MARK ON OUR U.S. ALT-A SECURITIES OF APPROXIMATELY \$6 BILLION IS CONSISTENT WITH TRADES IN THE MARKET AND THE PRICES OTHERS HAVE PUBLICLY DISCLOSED
    - AS WE'VE DETAILED ON PAGE [ ] OF THE PRESS RELEASE:

- OUR AAA SECURITIES, WHICH TOTAL \$[3.7] BILLION, ARE MARKED ON AVERAGE AT 78
- THE REMAINING SECURITIES, WHICH TOTAL \$[1.3] BILLION AND INCLUDE POSITIONS ACROSS THE CAPITAL STRUCTURE, ARE MARKED ON AVERAGE AT 37
- WE ALSO HAVE \$3.7 BILLION OF ALT-A WHOLE LOANS, WHICH ARE MOSTLY 2007 VINTAGE AND MARKED AT 86 ON AVERAGE
- OUR \$9.3 BILLION OF EUROPEAN RESIDENTIAL ASSETS IS PRINCIPALLY COMPRISED OF [U.K.] WHOLE LOANS, AND WE HAVE THESE MARKED ON AVERAGE AT [ ]

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- WE need to think long and hard as to whether or not we want to give prices. The concern is that someone in the market will believe they have a similar portfolio and point out that they have a lower price and you will be put on the defensive. If we keep it we need to make sure these amounts are clear from the PC work and be prepared to hand it over to the SEC, who will be very interested in understanding how you came to the prices you did. MY strong preference is not to give individual asset class pricing.

- TO PUT OUR MARKS IN PERSPECTIVE, THE AVERAGE LTV FOR OUR U.K. LOANS IS APPROXIMATELY 75%, AND HOME PRICES IN THIS MARKET HAVE DECLINED BY 7% FROM THEIR PEAK LEVELS IN OCTOBER 2007

- THIS COMPARES TO AVERAGE LTV OF [ ]% ON OUR U.S. LOAN BOOK, AND A MARKET DECLINE OF 17% IN U.S. HOME PRICES FROM THEIR PEAK IN JULY 2006
- OUR COMMERCIAL POSITIONS ARE REPRESENTED ON TWO SEPARATE LINES ON THE BALANCE SHEET – COMMERCIAL MORTGAGES OF \$30 BILLION, AND REAL ESTATE HELD FOR SALE OF \$11.1 BILLION; TOGETHER THESE TOTAL \$41.1 BILLION <DOES THIS INCLUDE THE GROSS UP?
  - WE’VE OUTLINED THE EXPOSURES ON PAGE [ ] IN OUR RELEASE
  - OUR VALUATION METHODOLOGIES AND POLICIES USE OBSERVABLE TRADES IN THE MARKETPLACE, OR BARRING THE AVAILABILITY OF THAT, MODELS THAT UTILIZE THIRD PARTY EVALUATIONS AND / OR CONSERVATIVE YIELD EXPECTATIONS
  - WE HAVE APPROXIMATELY \$5.3 BILLION OF SECURITIES, [77]% OF WHICH ARE RATED AA OR BETTER AND ARE MARKED AT [ ] ON AVERAGE
  - OUR WHOLE LOANS TOTAL \$[ ] BILLION AND ARE MARKED AT [ ] ON AVERAGE; TO GIVE YOU MORE DETAIL ON THESE POSITIONS:
    - [NUMBER OF LOANS; AVERAGE SIZE; LOANS >\$[ ] TOTAL \$[ ] BN]
    - [45]% OF LOANS ARE IN US, [28]% IN EUROPE AND [27]% IN ASIA
    - [ADD TOP STATES IN THE U.S; STATE LAS VEGAS AND PHOENIX]
    - [LIST TOP 5 COUNTRIES OUTSIDE THE U.S.]
    - NO SINGLE PROPERTY TYPE IS GREATER THAN [ ]%

- [CONSTRUCTION LOANS, HOTEL, OFFICE]
  - 75% ARE 1<sup>ST</sup> LIEN SENIOR LOANS AND 25% ARE MEZZANINE
  - THE AVERAGE AGE OF THESE LOANS IS LESS THAN 18 MONTHS,  
SO MOST OF THESE ARE 2007 VINTAGE
  - THE PORTFOLIO IS MOSTLY FLOATING RATE WITH A MATURITY  
OF APPROXIMATELY 1.5 YEARS - THOUGH MANY CONTAIN  
EXTENSION PROVISIONS
  - THE WEIGHTED AVERAGE LOAN TO VALUE RATIO IS  
APPROXIMATELY 74%
  - [AMOUNT CASH FLOWING AND WHAT IS COVERAGE]
  - [COMMENT ON AMOUNT OF MARK TAKEN AGAINST THESE OVER  
PAST 4 QTRS]
- WE HAVE APPROXIMATELY \$6.7 BILLION IN EQUITY POSITIONS,  
WHICH ARE MARKED CONSISTENT WITH MARKET YIELD  
EXPECTATIONS FOR ASSETS WITH COMPARABLE RISKS
- TO GIVE YOU A SENSE OF OUR THOUGHT PROCESS ON THIS, I'LL  
REVIEW OUR POSITION IN SUNCAL, AS FOLLOWS: <WHY DO THIS,  
IT REALLY ADDS NOTHING TO THE SPEECH AND ONLY OPENS  
YOU UP TO MORE QUESTIONS/INQUIRY
  - SUNCAL IS ONE OF THE LARGEST PRIVATELY HELD DEVELOPERS  
OF MASTER-PLANNED COMMUNITIES IN THE WEST

- LEHMAN'S EXPOSURE TO SUNCAL CONSISTS OF 23 RESIDENTIAL LAND DEVELOPMENT PROJECTS AND ONE LUXURY HIGH RISE RESIDENTIAL DEVELOPMENT LOCATED PRIMARILY IN SOUTHERN CALIFORNIA
- THIS POSITION HAS A CARRYING VALUE OF \$1.6 BILLION WHICH IS INCLUDED IN THE [EQUITY] LINE AND IS MARKED AT [ ]
- THE PORTFOLIO IS GENERALLY MARKED TO ACHIEVE A 15% UNLEVERED RETURN, AND WE CARRY THE PROPERTY AT A BASIS OF \$29,500 PER RESIDENTIAL LOT, INCLUDING THE \$20,000 PER LOT FOR INLAND EMPIRE WE NOTED LAST WEEK
- THIS WOULD COMPARE TO \$40,000 PER LOT IN RECENT COMPARABLE TRANSACTIONS
- OTHER KEY ASSUMPTIONS INVOLVED IN THE VALUATION INCLUDE [AVERAGE TIME PERIOD TO SELL THE LOTS]
- THIRD PARTY RESEARCH IS UTILIZED IN VALIDATING THE MODEL ASSUMPTIONS, AND OUR MODELS ARE UPDATED REGULARLY

- I'LL SPEND A FEW MOMENTS NOW ON OUR ARCHSTONE POSITION

AGAIN I STRONGLY SUGGEST YOU DO NOT DISCUSS INDIVIDUAL ASSETS.  
WHAT HAPPENS IF ONE OF THE OTHER INVESTORS PRICES DIFFERENTLY OR  
IF THERE IS ANY NEWS ON THEM IN THE FUTURE PEOPLE WILL WANT TO

HEAR HOW IT IMPACTED YOUR POSITION. THIS REALLY DOES NOT PROVIDE ANY MORE OR BETTER INFORMATION.

- ARCHSTONE IS A COMPANY WHICH OWNS A VERY DIVERSIFIED PORTFOLIO OF HIGH QUALITY APARTMENT ASSETS, THE UNDERLYING FUNDAMENTALS OF WHICH CONTINUE TO IMPROVE
  - FOR EXAMPLE, THE COMPANY HAD FIRST QUARTER SAME ASSET RENT GROWTH OF 5%
- ARCHSTONE ALSO HAS AN EXTENSIVE DEVELOPMENT PLATFORM AND LAND INVENTORY WHICH DO NOT GENERATE CURRENT CASH FLOW BUT HAVE SUBSTANTIAL VALUE
- OUR EQUITY EXPOSURE IN ARCHSTONE IS CURRENTLY VALUED AT LESS THAN \$1.6 BILLION, AND WE TOOK ADDITIONAL MARKS ON THE EQUITY POSITION OF \$350 MILLION THIS QUARTER
- WE HAVE ARRIVED AT AN ARCHSTONE ENTERPRISE VALUE USING A NUMBER OF DIFFERENT METHODOLOGIES, INCLUDING SUM-OF-THE-PARTS, DISCOUNTED CASH FLOW, REPLACEMENT COST, AND RECENT COMPARABLE TRANSACTIONS BASED ON BOTH CAP RATES AND PRICE PER UNIT, INCLUDING ASSET SALES FROM THE ARCHSTONE PORTFOLIO
- TO DATE, THE COMPANY HAS SOLD \$[ ] MILLION OF APARTMENT ASSETS AND CURRENTLY HAS \$[ ] MILLION OF ASSETS UNDER CONTRACT OR IN ACTIVE NEGOTIATION

- BASED ON THIS ANALYSIS, WE ARE VERY COMFORTABLE WITH OUR CURRENT ARCHSTONE MARK

- WE'VE TRIED TO PROVIDE MUCH MORE TRANSPARENCY INTO

OUR VALUATION PROCESS, SO THAT YOU GET A BETTER SENSE OF HOW

WE ESTABLISH ASSET VALUES

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- WITH RESPECT TO LEVEL III ASSETS, WE ARE STILL COMPLETING OUR REVIEW OF THE APPROPRIATE CATEGORIZATION OF OVER [50,000] POSITIONS

- HOWEVER, OUR CURRENT VIEW IS THAT LEVEL III ASSETS WILL BE DOWN SLIGHTLY VERSUS LAST QUARTER, AT APPROXIMATELY \$38.5 BILLION
- DURING THE QUARTER, WE SOLD \$[ ] BILLION OF LEVEL III ASSETS; INCLUDING \$[ ] BILLION OF MORTGAGE RELATED ASSETS
- THIS WAS OFFSET IN PART BY TRANSFERS IN OF \$[ ] BILLION OF EUROPEAN MORTGAGE PRODUCT
- LEVEL III BY DEFINITION INCLUDES THOSE ASSETS WITH LITTLE PRICE TRANSPARENCY; WHILE THERE IS MORE JUDGMENT USED IN ESTABLISHING THE VALUE OF THESE ASSETS, THIS DOES NOT IMPLY THAT THESE ASSETS HAVE LITTLE OR NO TRUE VALUE
- EXAMPLES OF ASSETS IN LEVEL III INCLUDE:
  - PRIVATE EQUITY INVESTMENTS OF APPROXIMATELY \$[ ] BILLION

- LONG-DATED DERIVATIVES FOR WHICH THERE IS NO ACTIVE TRADING MARKET
- MORTGAGE AND CORPORATE NPL PORTFOLIOS, WHICH ARE PURCHASED AT DEEP DISCOUNTS
- AND OTHER MORTGAGE ASSETS SUCH AS [ ]

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<WE NEED TO BE VERY COMFORTABLE WITH THIS INFORMATION AND THE CHANGES WE ARE NOT DONE YET ON OUR TESTING.

**RISK MANAGEMENT AND CAPITAL**

- OUR RISK NUMBERS DECLINED THROUGHOUT THE PERIOD AS OUR BALANCE SHEET AND EXPOSURE LEVELS DECLINED AS WELL, OFFSET IN PART BY MARKET VOLATILITY
- OUR PERIOD END VALUE AT RISK AT MAY 31<sup>ST</sup> WAS \$75 MILLION ON AN UNWEIGHTED BASIS, A DECLINE OF 16% COMPARED TO AN UNWEIGHTED VAR OF \$89 MILLION AT FEBRUARY 29<sup>TH</sup>
- AND OUR VALUE AT RISK AT MAY 31<sup>ST</sup> WAS \$104 MILLION ON A WEIGHTED BASIS, COMPARED TO A WEIGHTED VAR OF \$106 MILLION AT FEBRUARY 29<sup>TH</sup>

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- AND OUR EXPOSURE TO MONOLINES IS ALSO STILL MINIMAL

<is this true or is it our net after reserves exposure that is minimal

- TO QUANTIFY THIS RISK, IF MBIA AND AMBAC WERE TO DEFAULT ENTIRELY, OUR LOSSES ON RELATED POSITIONS WOULD BE \$235 MILLION

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<what about the AAA any need to discuss

- WE ENDED THE QUARTER WITH TOTAL STOCKHOLDER'S EQUITY OF APPROXIMATELY \$26 BILLION, UP 6% FROM THE FIRST QUARTER LEVEL
- OUR LONG-TERM CAPITAL ROSE TO \$156 BILLION FROM \$153 BILLION AT THE END OF THE FIRST QUARTER
- WE ESTIMATE THAT OUR TIER 1 CAPITAL RATIO UNDER THE BASEL II-LIKE CSE REGULATORY FRAMEWORK IS OVER 10% AT MAY 31, AND OUR TOTAL CAPITAL RATIO IS OVER 15%. BOTH AMOUNTS ARE PRE-CAPITAL RAISE, AND OUR TOTAL CAPITAL IS WELL IN EXCESS OF THE MINIMUM REQUIREMENT
  - THESE ESTIMATES ARE STILL PRELIMINARY, AND FINAL NUMBERS WILL BE INCLUDED IN OUR 10-Q
- OVER THE COURSE OF THE QUARTER, WE SLOWED OUR SHARE BUYBACK PROGRAM – REPURCHASING 2.7 MILLION SHARES AT AN AVERAGE PRICE OF \$40.15 PER SHARE
  - LONG-TERM WE WILL CONTINUE TO MANAGE DILUTION FROM EMPLOYEE EQUITY AWARDS WITH ONGOING SHARE REPURCHASES
  - IN THE NEAR-TERM, HOWEVER, WE EXPECT LIMITED REPURCHASE ACTIVITY AND WILL CONTINUE TO MONITOR THE EFFICACY OF BUYBACKS GOING FORWARD
- BOOK VALUE PER SHARE DECLINED THIS QUARTER TO \$34.21, DRIVEN BY OUR NET LOSS

- TAKING INTO ACCOUNT LAST WEEK'S CAPITAL RAISE, OUR PRO FORMA STOCKHOLDER'S EQUITY IS APPROXIMATELY \$32 BILLION, AND OUR PRO FORMA BOOK VALUE PER SHARE IS \$32.95

## **LIQUIDITY**

- NEXT, LET ME REVIEW OUR LIQUIDITY POSITION, WHICH HAS NEVER BEEN STRONGER
  - FIRST, WE HAVE SIGNIFICANTLY INCREASED OUR CASH CAPITAL SURPLUS AND LIQUIDITY POOL TO \$15 BILLION AND \$45 BILLION, RESPECTIVELY – AND AS OF TODAY THIS LIQUIDITY POOL IS \$[ ] BILLION, INCLUDING THE PROCEEDS FROM THE CAPITAL RAISE
  - WE COMPLETED OUR FUNDING PLAN FOR 2008
    - WE'VE ISSUED ALL THE LONG-TERM DEBT NECESSARY TO REFINANCE CURRENT PORTIONS THIS YEAR AND WILL NOT RETURN TO THE MARKET – WITH THE EXCEPTION OF POSSIBLE OPPORTUNISTIC PRE-FUNDING FOR 2009
  - WE HAVE ALSO INCREASED THE FUNDING PROVIDED BY OUR BANKS, AND WE WILL CONTINUE TO GROW THIS FUNDING SOURCE
    - WE HAD \$47 BILLION OF ASSETS FUNDED IN OUR BANKS AS OF THE SECOND QUARTER, UP FROM \$44 BILLION AT BOTH THE END OF THE FIRST QUARTER AND YEAR-END
  - ADDITIONALLY, WE HAVE INCREASED THE OVERFUNDING IN OUR TRI-PARTY FACILITIES AND ALSO EXTENDED THEIR MATURITIES

- OUR LIQUIDITY POOL NOW COVERS NOT ONLY THE SHORT-TERM UNSECURED FINANCING LIABILITIES AT THE HOLDING COMPANY AND UNREGULATED SUBSIDIARIES OF APPROXIMATELY \$31 BILLION, BUT ALSO GIVES US AN ADDITIONAL \$14 BILLION OF LIQUIDITY FOR OTHER UNFORESEEN EVENTS (NOT INCLUDING ADDITIONAL UNDRAWN LONG-TERM COMMITTED FACILITIES OF \$4.5 BILLION)
  - THE LIQUIDITY POOL IS PRIMARILY INVESTED IN CASH INSTRUMENTS, GOVERNMENT AND AGENCY SECURITIES AND OVERNITE REPURCHASE AGREEMENTS COLLATERALIZED BY GOVERNMENT AND AGENCY SECURITIES
  - IN ADDITION, OUR HOLDING COMPANY AND UNREGULATED AFFILIATES HAVE APPROXIMATELY \$59 BILLION OF ADDITIONAL UNENCUMBERED COLLATERAL
  - OUR BANK ENTITIES AND REGULATED BROKER DEALERS ALSO CARRY EXCESS LIQUIDITY OF APPROXIMATELY \$87 BILLION OF UNENCUMBERED COLLATERAL TO FUND QUALIFYING ASSETS
- WE HAVE TESTED THE FED'S NEW PRIMARY DEALER CREDIT FACILITY ON OCCASION, WITH NO OUTSTANDING BALANCE AT QUARTER END
  - THE LAST TIME WE ACCESSED THE FACILITY WAS APRIL 16TH ON AN OVERNIGHT BASIS
- WITH RESPECT TO OUR SECURED FUNDING POSITION
  - TOTAL REPO IS APPROXIMATELY \$188 BILLION

- OF THIS AMOUNT, APPROXIMATELY \$83 BILLION IS HIGH QUALITY COLLATERAL USED BY CENTRAL BANKS FOR THEIR OPEN MARKET OPERATIONS THAT CAN BE FUNDED READILY
- THE REMAINING \$105 BILLION IS TRI-PARTY REPO, OF WHICH APPROXIMATELY \$40 BILLION CONSISTS OF CENTRAL BANK-ELIGIBLE COLLATERAL
- THE AVERAGE TENOR OF OUR TRI-PARTY REPO IS NOW UP TO 50 DAYS
  - 46% OF OUR TRI-PARTY REPO BOOK HAS A MATURITY OF GREATER THAN A WEEK AND 29% IS GREATER THAN A MONTH
- ADDITIONALLY, WE HAVE OVER-FUNDED THE REPO BOOK BY APPROXIMATELY \$27 BILLION
  - THIS GIVES US THE ABILITY TO MAXIMIZE EACH REPO FACILITY IN TIMES OF STRESS AND REALLOCATE THE HIGHER QUALITY, EASY-TO-FUND COLLATERAL OUTSIDE THESE FACILITIES IF NECESSARY

### **OUTLOOK & CONCLUSION**

- OUR CAPITAL RAISE LAST WEEK GIVES US SIGNIFICANT FLEXIBILITY AS WE LOOK TO BRING DOWN OUR COMMERCIAL MORTGAGE EXPOSURES, AND AT THE SAME TIME DEPLOY OUR NEW CAPITAL

- WITH TOTAL SHAREHOLDER'S EQUITY TODAY OF OVER \$32 BILLION, OUR CAPITAL BASE IS NOW COMPARABLE TO OTHERS IN THE INDUSTRY
- WE EXPECT TO BRING DOWN OUR COMMERCIAL MORTGAGE EXPOSURE AND REAL ESTATE ASSETS BY APPROXIMATELY 20% BY YEAR-END, WITH FURTHER REDUCTIONS THEREAFTER
  - TO DATE, WE PURSUED INDIVIDUAL ASSET SALES TO REDUCE THESE EXPOSURES
  - WE HAVE ALSO INITIATED DIALOGUES WITH STRATEGIC PARTNERS, WHEREBY WE COULD SIGNIFICANTLY REDUCE EXPOSURE WHILE RETAINING SOME PORTION OF UPSIDE ON THESE ASSETS
  - AS AN ASSET CLASS, WE BELIEVE OUR AGGREGATE EXPOSURE TO RESIDENTIAL MORTGAGES IS NOW APPROPRIATE GIVEN OUR CAPITAL BASE AND IN LINE WITH PEERS; HOWEVER, WE WILL CONTINUE TO ACTIVELY TRADE THAT BOOK
  - SIMILARLY IN ACQUISITION FINANCE, WE BELIEVE OUR AGGREGATE EXPOSURE AND RISK IS APPROPRIATELY SIZED; IN THE FUTURE, AS EXPOSURES WILL ROLL OFF AND WE WILL ADD NEW POSITIONS WITH MARKET TERMS
- OVER THE PAST WEEK, MANY OF YOU HAVE RAISED QUESTIONS ABOUT OUR HOW WE WILL DEPLOY THE EQUITY WE RAISED IN LAST WEEK'S OFFERING, AND ABOUT THE IMPACT THIS NEW EQUITY WILL HAVE ON OUR

ABILITY TO EARN SUFFICIENT RETURNS IN A LOWER LEVERAGE ENVIRONMENT

- THIS IS OBVIOUSLY AN IMPORTANT ISSUE, AND SO I WANT TO SPEND A FEW MINUTES GOING THROUGH OUR VIEWS ON IT IN SOME DETAIL
- OVERALL, WE THINK THAT EVEN WITH LOWER LEVERAGE – THAT IS, NET LEVERAGE IN THE LOW DOUBLE DIGITS AND GROSS LEVERAGE OF AROUND 25 TIMES – WE CAN EARN ROEs IN THE MID-TEENS, AND THAT WE CAN DO THIS BY FOCUSING ON OUR CORE CLIENT FRANCHISE
- THIS MEANS BEING DISCIPLINED AROUND HOW WE ALLOCATE OUR CAPITAL AND FOCUSING OUR BALANCE SHEET ON HIGH VELOCITY, HIGH RETURN-ON-ASSET FACILITATION BUSINESSES WHERE THE RISK-REWARD TRADEOFF MAKES SENSE
- IT WOULD ALSO INCLUDE BUILDING OUT WHAT WE SEE AS A NUMBER OF HIGH GROWTH, HIGH ROA BUSINESSES WHERE WE HAVE ALREADY MADE SIGNIFICANT INVESTMENTS, SUCH AS COMMODITIES, FX, STRUCTURED DERIVATIVES, TRADITIONAL ASSET MANAGEMENT, ALTERNATIVES AND OBVIOUSLY INVESTMENT BANKING
- TO GIVE YOU SOME SENSE OF HOW THIS TRANSLATES INTO RETURNS, LET ME TAKE A MINUTE TO WALK YOU THROUGH A SET OF HIGH-LEVEL ECONOMICS FOR WHAT WE THINK THE FRANCHISE CAN GENERATE IN A MORE “NORMALIZED” ENVIRONMENT
- THIS IS NOT INTENDED TO BE A FORECAST FOR WHAT WE WILL EARN IN THE NEXT QUARTER OR OVER THE NEXT YEAR

- INSTEAD IT IS DESIGNED TO BE AN INDICATION OF WHAT WE THINK OUR OPERATING ECONOMICS COULD BE ONCE WE GET THROUGH THE CURRENT PERIOD
- LET'S START WITH OUR CAPITAL AND BALANCE SHEET
- COMING OUT OF LAST MONDAY'S OFFERING, WE HAVE ABOUT \$32 BILLION IN LEVERAGEABLE EQUITY THAT WE CAN DEPLOY ACROSS THE FIRM
- AT 12.5 TIMES NET LEVERAGE, THAT SUPPORTS APPROXIMATELY \$400 BILLION IN NET ASSETS. THIS BALANCE SHEET IS MORE NEARLY 10% LARGER THAN THE ONE WE REPORTED AT THE END OF 2007
- SO, THE FINANCIAL RESOURCES WE CAN PUT ON THE FIELD TODAY, EVEN AT LOWER LEVERAGE, ARE GREATER THAN WHAT WE HAD AVAILABLE TO US IN WHAT WAS A RECORD YEAR FOR THE FIRM
- THE QUESTION IS WHAT KIND OF REVENUE WE CAN GENERATE FROM THESE ASSETS?
- WE BELIEVE THAT IN A MORE "NORMALIZED" MARKET ENVIRONMENT, OUR FRANCHISE CAN GENERATE APPROXIMATELY \$5 BILLION IN NET REVENUE PER QUARTER. THIS WOULD REPRESENT ABOUT A 4.7% ANNUALIZED RETURN ON NET ASSETS

<need to make sure we want to say this as it will be expected going forward no matter how many caveats you add

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- TO GIVE YOU SOME CONTEXT FOR THIS NUMBER, WE EARNED SLIGHTLY MORE THAN THIS – ABOUT 4.9% ROA – IN 1999, THE YEAR AFTER THE RUSSIAN DEBT CRISIS AND LONG TERM CAPITAL MANAGEMENT

- AND THIS 4.7% WOULD BE SIGNIFICANTLY LOWER THAN THE ~5.3% ROA THAT WE HAVE AVERAGED DURING OUR 14 YEARS AS A PUBLIC COMPANY
- SO ALL IN, 4.7% FEELS LIKE IT IS WITHIN THE STRIKE ZONE OF REASONABILITY FOR THIS DISCUSSION
- TO EXPLAIN WHY THIS ALSO SEEMS REASONABLE AT THE BUSINESS LEVEL, LET ME WALK YOU THROUGH OUR INDIVIDUAL DIVISIONS, ONE BY ONE
- FIRST, FIXED INCOME:
- DURING THE FIRST HALF OF 2008, WE GENERATED APPROXIMATELY \$1.6 BILLION IN CLIENT FACILITATION REVENUES IN FIXED INCOME. THIS NUMBER REPRESENTS OUR BEST ESTIMATE OF TRUE "CLIENT REVENUES" IN THE BUSINESS AND EXCLUDES ANY GAIN OR LOSS FROM TRADING ACTIVITIES
- THESE TRADING ACTIVITIES OBVIOUSLY GENERATED NEGATIVE REVENUES FOR THE BUSINESS DURING THE MOST RECENT QUARTER
- HOWEVER, TRADING ACTIVITIES ARE TYPICALLY POSITIVE FOR US IN THIS BUSINESS AND USUALLY ACCOUNT FOR MORE THAN 25% OF TOTAL FIXED INCOME REVENUES
- SO ALL IN, WE THINK THIS BUSINESS CAN GENERATE AT LEAST \$1.8 BILLION IN QUARTERLY REVENUES ON A GO-FORWARD BASIS, GIVEN THE STRENGTH OF OUR UNDERLYING CLIENT FRANCHISE
- TURNING TO EQUITIES, WE FEEL THIS BUSINESS CAN GENERATE APPROXIMATELY \$1.3 BILLION IN QUARTERLY REVENUES ON A GO-FORWARD BASIS

- TO GIVE YOU SOME CONTEXT HERE, WE CAN LOOK AT OUR EXPERIENCE DURING 2007 WHEN THIS BUSINESS EARNED ABOUT \$1.6 BILLION PER QUARTER
- IN FACT, DURING THAT YEAR, OUR EQUITIES FRANCHISE EARNED MORE THAN \$1.3 BILLION IN EVERY SINGLE QUARTER
- AND, NOTWITHSTANDING A CHALLENGING MARKET ENVIRONMENT DURING THE FIRST HALF OF THIS YEAR, OUR EQUITIES BUSINESS HAS GENERATED MORE THAN A BILLION DOLLARS PER QUARTER IN “CLIENT FACILITATION” REVENUES
- AGAIN, THIS NUMBER EXCLUDES ANY REVENUES FROM TRADING
- SO AS WITH FIXED INCOME, WE THINK WE CAN ACHIEVE \$1.3 BILLION IN REVENUE ALMOST ENTIRELY ON THE BASIS OF OUR CLIENT FACILITATION FRANCHISE
- TURNING TO INVESTMENT MANAGEMENT, WE FEEL THIS BUSINESS CAN EARN APPROXIMATELY \$1 BILLIONN PER QUARTER ON A RELATIVELY CONSISTENT BASIS, DUE TO THE ANNUITIZED NATURE OF THIS REVENUE STREAM
- OVER THE PAST 4 QUARTERS, THIS BUSINESS HAS EARNED AN AVERAGE OF ABOUT \$900 MILLION, AND IT HAS BEEN GROWING RELATIVELY CONSISTENTLY
- IF YOU LOOK BACK OVER THE PAST YEAR AND HALF, OUR INVESTMENT MANAGEMENT FRANCHISE HAS INCREASED REVENUES BY AN AVERAGE OF \$100 MILLION PER QUARTER

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- SO, \$1 BILLION IN QUARTERLY REVENUE SEEMS REASONABLE IN THE FORESEEABLE FUTURE
- FINALLY, WE THINK OUR INVESTMENT BANKING BUSINESS CAN GENERATE APPROXIMATELY \$800 MILLION A QUARTER IN A MORE “NORMALIZED” ENVIRONMENT
- TO GIVE YOU SOME SENSE OF THIS, IT MIGHT BE HELPFUL TO THINK ABOUT OUR PERFORMANCE IN PRIOR PERIODS
- IN 2005, WHICH WAS A MORE “NORMALIZED” MARKET, OUR BANKING BUSINESS EARNED AN AVERAGE OF OVER \$700 MILLION PER QUARTER
- AND IT DID THIS WITH A MATERIALLY SMALLER HEADCOUNT AND SIGNIFICANTLY SMALLER FOOTPRINT IN EUROPE AND ASIA
- SINCE THAT TIME, WE HAVE INCREASED EUROPEAN INVESTMENT BANKING HEADCOUNT BY MORE THAN 30%, AND ASIA INVESTMENT BANKING HEADCOUNT BY MORE THAN 140%

- SO AGAIN, WE FEEL THAT THIS LEVEL OF REVENUE IS PLAUSIBLE ON A GOING FORWARD
- PUTTING IT ALL TOGETHER, WE CAN SEE THE FRANCHISE GENERATING NET REVENUES OF JUST UNDER \$5 BILLION PER QUARTER, OR APPROXIMATELY \$19.6 BILLION PER YEAR <this is what everyone will expect
- WITH COMPENSATION AT 49.3% OF REVENUES AND \$1 BILLION IN QUARTERLY NPE EXPENSE, THIS WOULD PRODUCE JUST OVER \$1 BILLION IN NET INCOME AND AN ROE OF JUST UNDER 15%
- AGAIN, I WANT TO EMPHASIZE THAT THIS IS NOT A FORECAST FOR OUR BUSINESS

- BUT IT DOES GIVE YOU SOME SENSE FOR THE KIND OF RETURNS OUR MODEL MIGHT GENERATE IN A MORE NORMALIZED MARKET
- SSS
- NOW I WILL BE HAPPY TO TAKE QUESTIONS

### **Q&A**

### **CLOSING REMARKS**

- THANK YOU AGAIN FOR JOINING US TODAY, AND WE LOOK FORWARD TO SPEAKING WITH YOU NEXT QUARTER