LEHMAN BROTHERS

May 12, 2008

# Q2 2008 Update

Confidential Presentation

# Overview

**Lehman's strong credit position is predicated on four key strengths: a vibrant client franchise that drives sustainable earnings, a capital base that provides enough cushion to weather the current economic downturn, a strong liquidity framework and a superio risk management framework that allows Lehman to target an appropriate level of risk**

- Lehman's underlying client franchise remains strong, providing a solid revenue base going forward
  - Lehman has performed well during the first nine months of the economic downturn
    - Maintained positive earnings during the period
    - Performance driven by strong client franchise and effective hedging of asset writedowns
    - Client revenues are just as strong in Q2 and Lehman is gaining market share in a difficult market environment
  - Despite the continuing strength of Lehman's core client franchise, the Firm expects to report a Q2 '08 loss due to an unexpected technical divergence between the derivatives and cash markets as well as the underperformance of certain defensive trading positions
    - Even after taking into account the expected Q2 loss, Lehman will still have positive earnings over the period encompassing the economic downturn
  - Gross asset writedowns are declining
    - Q2 '08 gross writedowns are only 40% of Q1 '08 levels as of the end of April
    - At the same time, the technical divergence between the cash and derivatives markets has resulted in a significant decline in the effectiveness of hedges designed to offset Lehman's asset writedowns
    - Hedge positions that offset 70% of Lehman's asset writedowns over the past three quarters resulted in net Q2 losses, driving a significant decline in Lehman's revenues and earnings

# Overview

- Despite the difficult market environment in 2008 and the forecasted Q2 ’08 loss, Lehman has strengthened its capital position, which is now stronger than it was in Q1 ‘08
  - $7.9 billion of new capital raised since February
  - Active deleveraging via balance sheet reduction
  - Lehman’s current capital ratios and financial position stronger than when it was upgraded in October [2005: S&P] [2003: Moody’s]
  - No immediate need for incremental capital post Q2 ‘08, although Lehman remains open to opportunistically accessing the capital markets depending on market conditions

- Lehman’s liquidity position is also stronger than it was at the end of Q1 ’08
  - Liquidity pool and cash capital surplus expected to be 13% and 40% higher than end of 1Q, respectively

- Lehman’s strong risk management framework has allowed the company to maintain a stable risk profile despite increasing market volatility
  - Active deleveraging resulting in reduced exposure to high-risk asset classes
  - Current VaR and risk appetite are in line with Q1 ’08 levels

# Overview

- Although the market is not currently expecting a Q2 loss of this magnitude, we believe that when it understands that the loss is driven by the technicals-driven underperformance of Lehman's asset-writedown hedges, it will recognize that the Firm is positioned to perform well during the rest of 2008
  - Strong performance of client businesses highlight Lehman's exceptional franchise
  - Declining gross asset writedowns
  - Lehman will report positive earnings for the entire 12 month period of the economic downturn

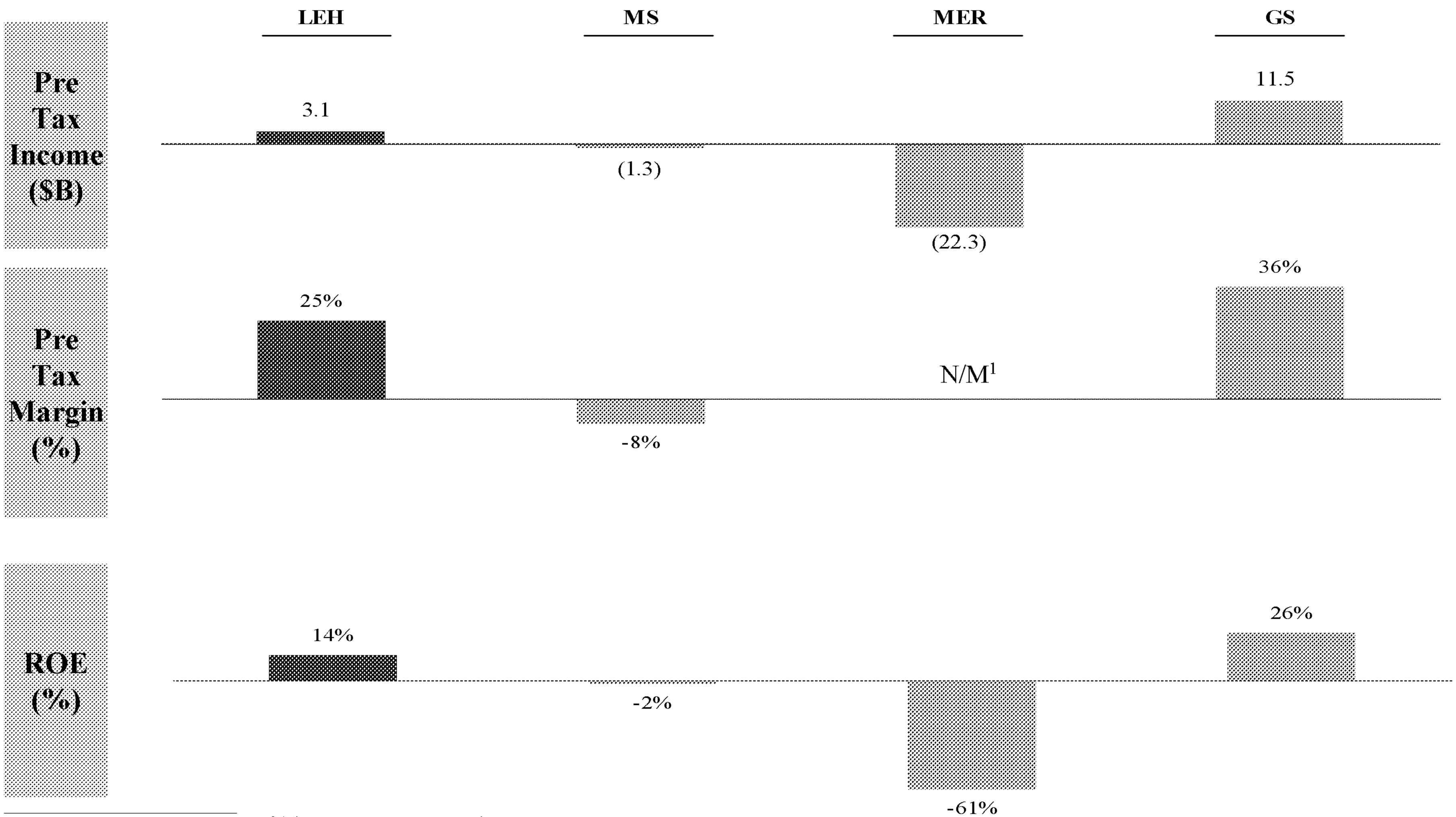
- Furthermore, Lehman has proactively implemented a number of key restructuring initiatives designed to respond to the rapidly evolving economic environment and position the Firm to drive growth in market share and revenue growth when the economic cycle turns positive in 2009
  - Rationalization of specific businesses
  - Rightsizing the firm
  - Proactive raising of capital when the market has been attractive
    - "Raise capital when you can, not when you have to"
  - [More details about Lehman restructuring initiatives]

# Q2 ’08 Results: Strong Performance of Client Franchise

# The Firm Has Successfully Navigated the Past Three Quarters…

## Lehman had the strongest performance after GS among leading US broker-dealers over the last nine months (Q3 ’07 – Q1 ‘08)

- Even with the expected Q2 loss, Lehman still expects to generate positive earnings during the current downturn




1. *MER pre-tax margin not meaningful due to negative revenue and negative pre-tax income*

# …Driven Primarily by Strong Core Client Revenues…

**Lehman's client revenues have strengthened during the economic downturn, as evidenced by strong overall volumes and higher market share**

- Lehman's client revenues in Q2 '08 were strong in a particularly difficult economic environment, and were only down 6% from Q1 levels and 2% year-over-year
- The strength of client revenues also highlights the increasing diversification of Lehman's business model and its declining reliance on Fixed Income revenues over time

**Client revenues bar chart from Q2 '06 to Q2 '08**

Broken out by market segment (showing overall volumes have been high and consistent). Also calculate pre and post downturn averages and standard deviations.

**Lehman Market share line chart from Q2 '06 to Q2 '08**

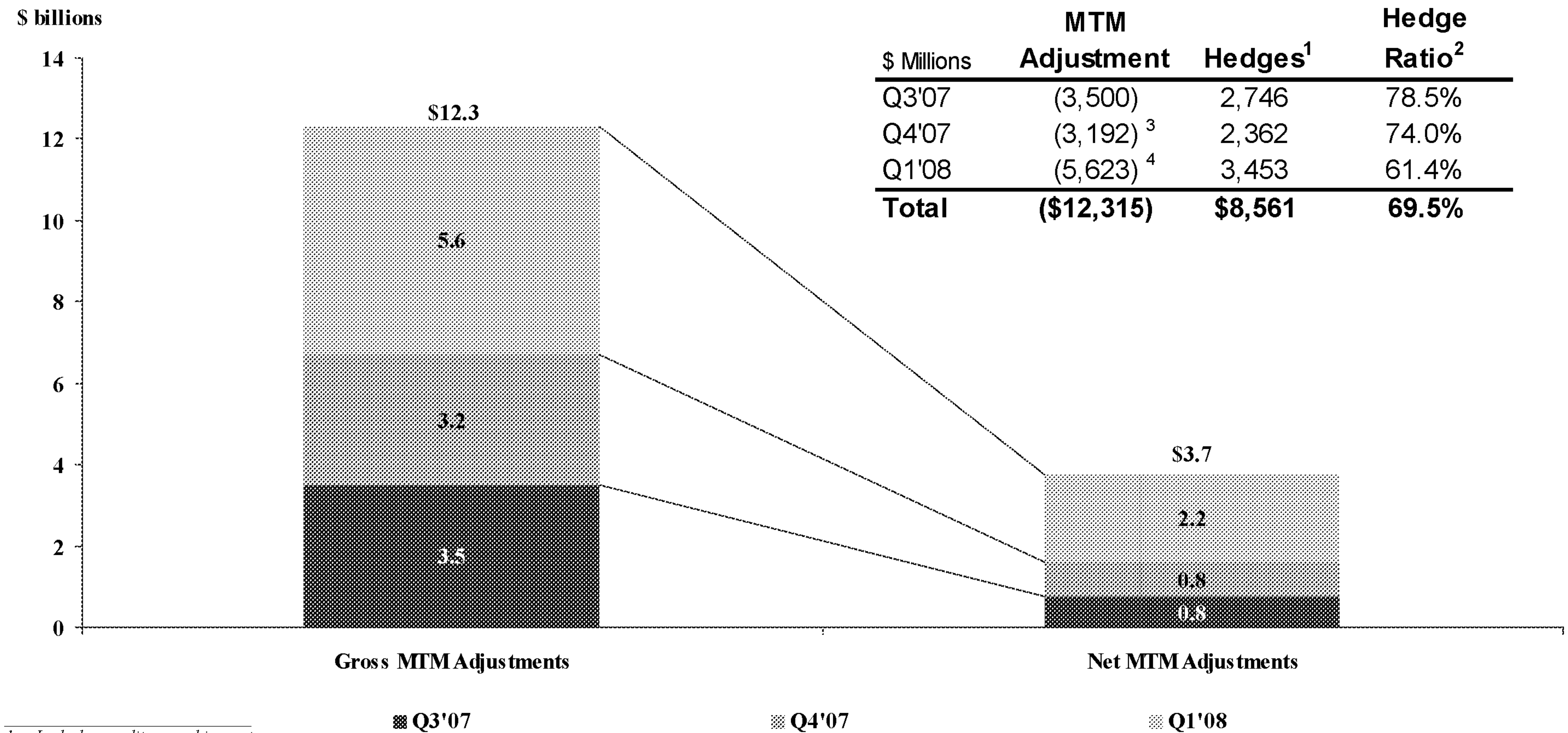
Broken out by FID, equity and capital origination/M&A (showing that Lehman market share has increased). Not sure we can get this for all segments but we are trying.

Also will have a graph that shows year-over-year growth of revenues broken down by specific product area (to show the broad strength of Lehman's franchise across Fixed Income sectors as well as Equities, IBD and IMD). In other words, revenue growth is not just driven by growth in a few market segments.

# …As Well As An Initially Successful Hedging Strategy

**Lehman's ability to successfully hedge its asset writedowns from Q3 '07 to Q1 '08 has been instrumental in generating positive earnings over the period**

**Gross and Net MTM Adjustments Q3 '07 - Q1 '08**



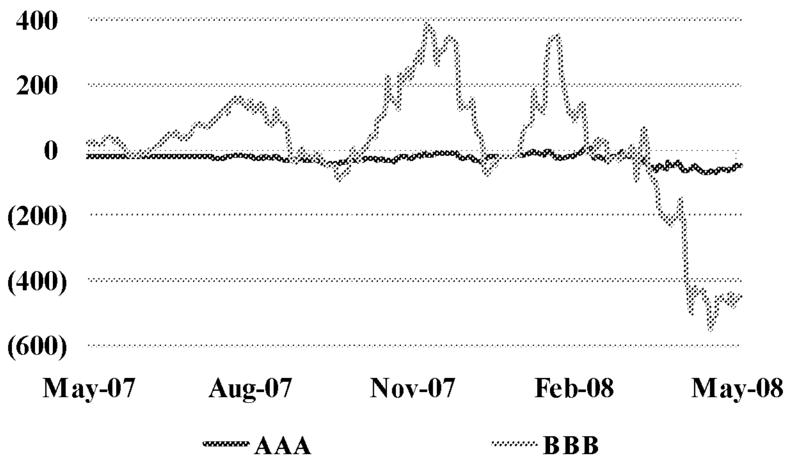

| $ Millions | MTM Adjustment | Hedges[1] | Hedge Ratio[2] |
|---|---|---|---|
| Q3'07 | (3,500) | 2,746 | 78.5% |
| Q4'07 | (3,192) [3] | 2,362 | 74.0% |
| Q1'08 | (5,623) [4] | 3,453 | 61.4% |
| **Total** | **($12,315)** | **$8,561** | **69.5%** |

1. *Includes credit spread impact*
2. *Effective hedge ratio is defined as Gross MTM adjustments offset by hedges and credit spread impact*
3. *Includes gains on leverage loans sold during the quarter*
4. *Reported $4.7B in the Q1 earnings release. Difference relates to .2m in FRL and Loan Holds, .1m in PE and Asset Management, and .6m in credit spreads (the latter is included w/i hedges)*

# Success of Q2 Hedges Compromised By Weak Correlation Between the Cash and Derivatives Markets…[Update]

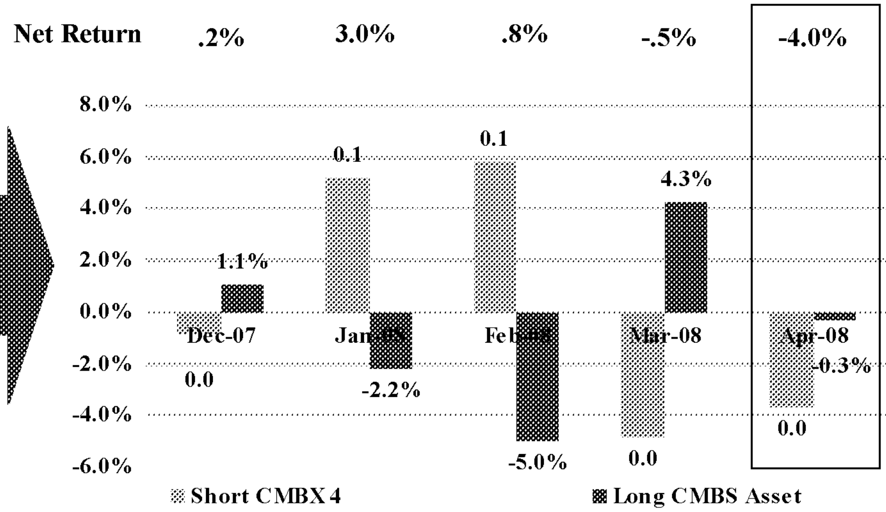
**The success of Lehman's hedging strategy over the past nine months has been driven by our ability to offset movements in cash assets with derivative instruments**

**CMBS Basis between Derivatives and Cash**




Significant gap between CMBX derivatives and underlying CMBS Cash Assets appeared in April…

**CMBS Long Cash vs. Short Derivative Mo. Return**



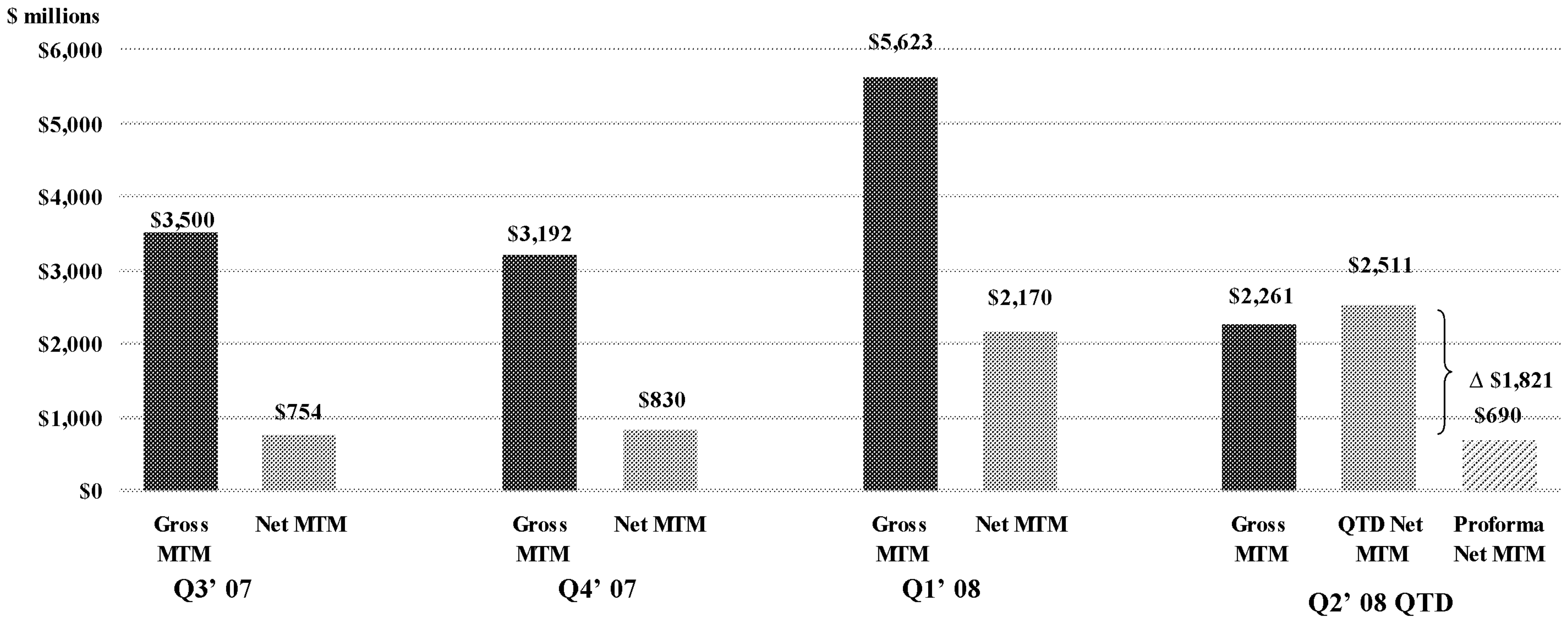

…Resulting in a situation where the firm was adversely impacted on both its long cash and short derivative positions

# … Driving Hedge Ineffectiveness That Had An Oversized Impact on Revenues… [Update]

**Whereas Lehman's effective hedge ratio was 70% during the first nine months of the downturn, it has actually been -11.0% so far in Q2 '08 (i.e., our hedges have actually been counterproductive)**

- Assuming a hedge ratio consistent with the average of the last three quarters, the Firm's Net MTM (i.e., after hedges) would have been $(690) million versus the actual of $(2,511) million for a net impact of $1,821 million to net revenues

**Hedge Effectiveness Q3 '07 – Q2 '08**



# …And Resulting in a Particularly Challenging Q2 '08 [To Be Updated to Incorporate Client vs. Non-Client Revenues and Impact of Defensive Trading Positions]

**Although the Firm is expected to suffer significant revenue compression this quarter, a large portion can be attributed to idiosyncratic events**

- During the turbulent Q2 '08 period, Lehman has maintained a strong core revenue run rate from client operations
  - Revenue run rate increased from March to April
- Revenue run rate was adversely impacted by short credit positions [1] supporting Lehman's client franchise, as well as a defensive long position in interest rates

**Net Revenue Forecast [will add Q3 and Q4 and will combine Q2 into one item when we can get May results]**

| *$ millions* | *Actual* Q1'08 | *Actual* Q2 TD | *Forecast* May-08 | *Forecast* Q2'08 | Q1 to Q2 Variance |
|---|---|---|---|---|---|
| Revenue Run Rate | $ 5,320 | $ 1,847 | $ 1,900 | 3,747 | -30% |
| Principal Investments | 155 | (275) | - | (275) | -277% |
| CVA[2], Commodities GAAP and Corporate | 202 | (335) | - | (335) | -266% |
| Mark to Market | (5,623) | (2,261) | (700)[3] | (2,961) | -47% |
| Hedges | 2,836 | (441) | | (441) | -116% |
| Credit Spread | 617 | 191 | 200 | 391 | -37% |
| Total MTM | (2,170) | (2,511) | (500) | (3,011) | 39% |
| Net Revenue | $ 3,507 | $ (1,274) | $ 1,400 | $ 126 | -96% |

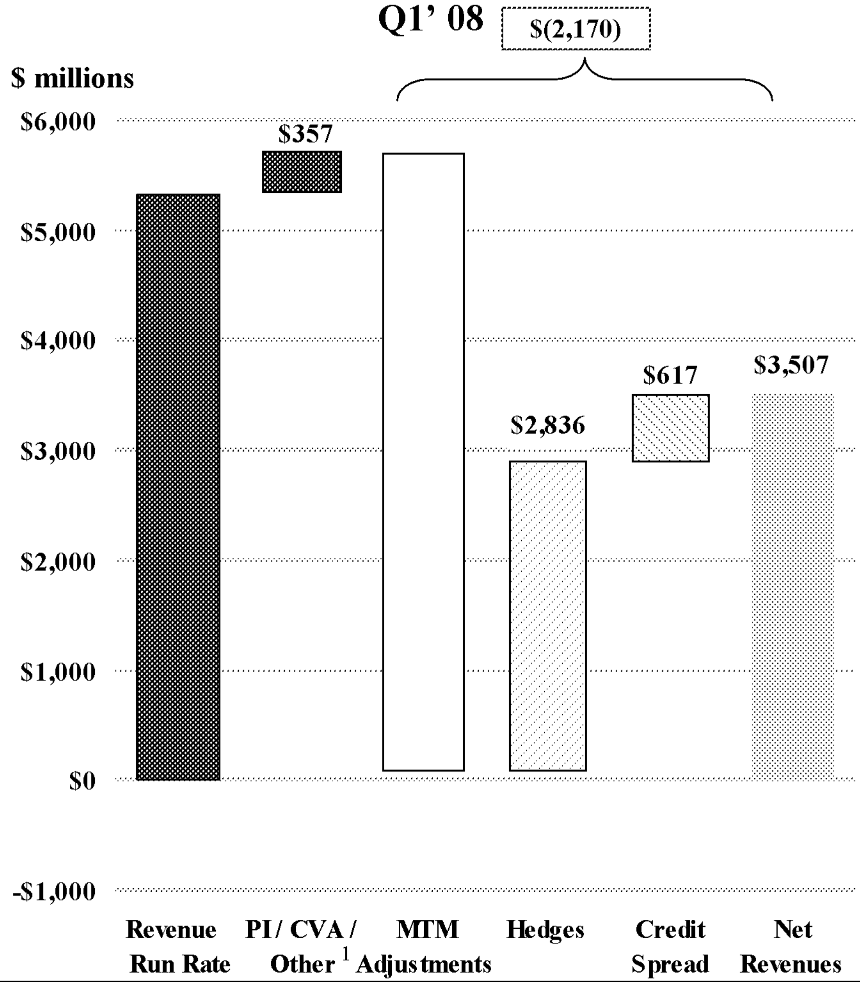
1. *Lehman benefited from the short credit position in Q1 '08*
2. *CVA stands for Credit Valuation Adjustment – these are reserves taken against the firm's derivatives book*
3. *Forecast for MTM adjustments net of hedges*

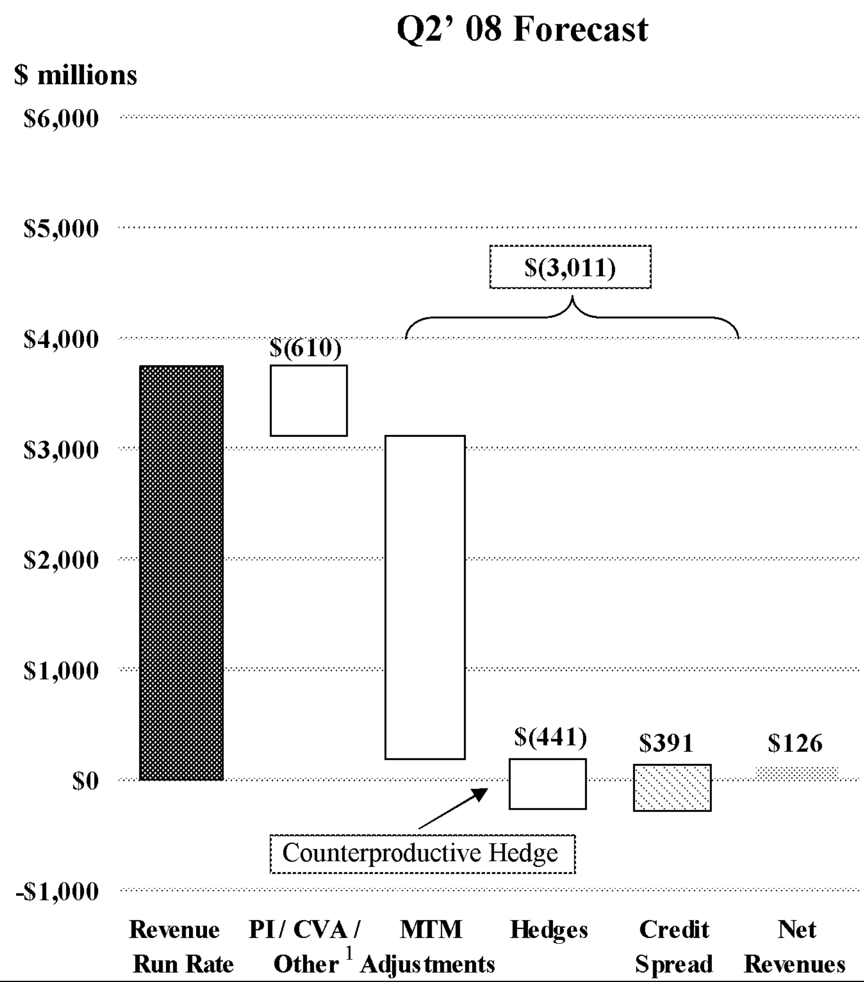
# …And Resulting in a Particularly Challenging Q2 '08 [To Be Updated to Incorporate Client vs. Non-Client Revenues and Impact of Defensive Trading Positions]

**Lehman's hedges actually worked against the Firm, exacerbating the impact of asset markdowns on revenues**

- Further impacting Q2 revenues were the defensive market positions that Lehman took in Q1 as "macro hedges" which, like Lehman's other hedges, worked against the Firm

**Net Revenue Components**




1. *Commodities GAAP adjustments and Corporate P&L*

# Other Factors Also Contributed to Poor Q2 '08 Results

**Although the Firm is expected to suffer significant revenue compression this quarter due to the inefficiency of its hedging positions, a large [?] portion can also be attributed to a combination of idiosyncratic events that are the result of "the perfect storm"**

- The goal here is to have a chart that breaks down the gap between Q1 and Q2 revenues ($3.5 bn) into digestible "chunks". Inefficient hedges and defensive market positions explain the majority, but this will show that there were a bunch of other small "dings" that when combined add up to a significant number
- Each "chunk" will have an associated notation as to why it is idiosyncratic.

**Breakdown of the Gap Between Q1 and Q2 Revenues by Breaking it into little pieces**

Revenue Run Rate

  Client Revenues (By segment)

  Non-Client (Trading) Revenues (By segment)

  Defensive Trading Position

  Principal Investment

Gross Writedowns

Hedges

Credit Spread

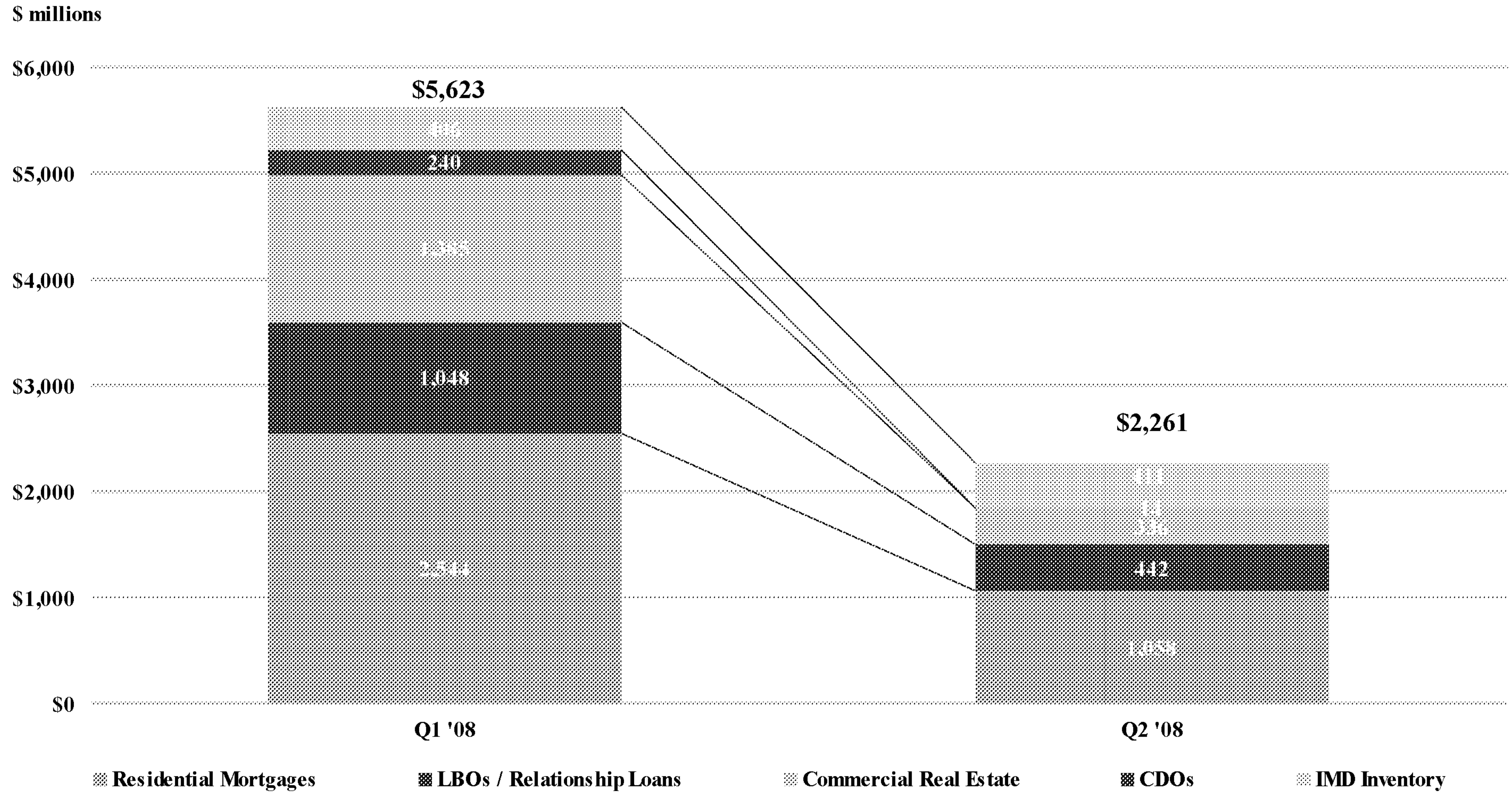
CVA

Net differential

# A Significant Reduction in Gross Writedowns…

**Lower writedowns may signal a more rational framework for pricing securities and an eventual reconnection between the cash and derivatives markets**

### Gross Writedowns



# …Which We Expect To Continue In the Future

**Lehman's writedowns of mortgage assets to lower price levels has significantly increased trading volumes and liquidity, suggesting a downward trend in future writedowns for mortgage securities**

**Gross Writedowns vs. Prices vs. Market Liquidity**

Graph that shows sub-prime and prime mortgage prices on Lehman's balance sheet for 1Q, March and April and how they correlate with sales of these assets. Strong correlation shows that current prices are appropriate and are driving sales and liquidity

# …Which We Expect to Continue In the Future

**The attractive yields implied by current MBS price levels is driving the increase in liquidity observed in the markets**

**Implied Yields on MBS**

Graph that shows current yields on MBS given current prices. Faizal is working on trying to get this data.

# Overview of Second Half Earnings [TBU]

## It is extremely difficult to forecast expected second half performance

- Current bottoms-up estimates provide a net revenue range of between $12.5 - $15.0 billion for all of FY 2008
- Our earlier breakdown of Q2 results and the idiosyncratic factors driving its results suggests that our Q3 and Q4 estimates are reasonable

**FY2008 Net Revenue and Net Income Estimate**

| Divisional Revenues | *Actual* FY '07 | *Actual* Q1 '08 | *Forecast* Q2 '08 | *Estimated Range* H2 '08 | | | *Estimated Range* FY '08 | | |
|---|---|---|---|---|---|---|---|---|---|
| Fixed Income | $6,015 | $979 | ($1,044) | $4,200 | – | $5,400 | $4,135 | – | $5,335 |
| Equities | 6,073 | 1,416 | 1,250 | 2,734 | – | 3,584 | 5,400 | – | 6,250 |
| Investment Banking | 3,581 | 119 | 108 | 1,473 | – | 1,573 | 1,700 | – | 1,800 |
| Investment Management | 2,857 | 303 | 297 | 1,575 | – | 1,700 | 2,175 | – | 2,300 |
| Principal Investing | 1,715 | 155 | (275) | 610 | – | 880 | 490 | – | 760 |
| Banking and PIM Eliminations [1] | (2,453) | (286) | (335) | (1,229) | – | (1,274) | (1,850) | – | (1,895) |
| Corporate | 1,469 | 821 | 125 | (496) | | | 450 | | |
| **Net Revenues** | **19,257** | **3,507** | **126** | **8,867** | – | **11,367** | **12,500** | – | **15,000** |
| Compensation and Benefits | 9,494 | 1,841 | 1,825 | 3,934 | – | 4,534 | 7,600 | – | 8,200 |
| Non-Personnel Expenses | 3,750 | 1,003 | 1,030 | 1,967 | | | 4,000 | | |
| Total Expenses | 13,244 | 2,844 | 2,855 | 5,901 | – | 6,501 | 11,600 | – | 12,200 |
| Pre-Tax Income | 6,013 | 663 | (2,729) | 2,966 | – | 4,866 | 900 | – | 2,800 |
| Taxes | 1,821 | 174 | (732) | 801 | – | 1,314 | 243 | – | 756 |
| **Net Income** | **4,192** | **489** | **(1,997)** | **2,165** | – | **3,552** | **657** | – | **2,044** |

1. *Eliminations of shared revenues across divisions*

# Capital Adequacy

# 2008 YTD Capital Actions…

**The Firm has continued to bolster its capital with a total of $7.9 billion in new issuances since February, all of which are eligible for inclusion within CSE's definition of Total Capital**

**$1.9 B Preferred Stock**

- Issued in February 2008
- Non-Cumulative Dividends at 7.95%, Perpetual
- Includes Greenshoe of ~$250 million
- Deeply Subordinated and senior only to Common Equity
- Included as CSE Equivalent Tier 1 Capital

**$4.0 B Convertible Preferred Stock**

- Issued in April 2008
- Non-Cumulative Dividends at 7.25%

  Initial Conversion Rate 20.0509 per share, equivalent to $49.87 strike per share
- Perpetual
- Deeply Subordinated and senior only to Common Equity
- Included as CSE Equivalent Tier 1 Capital
- More than three time over subscribed

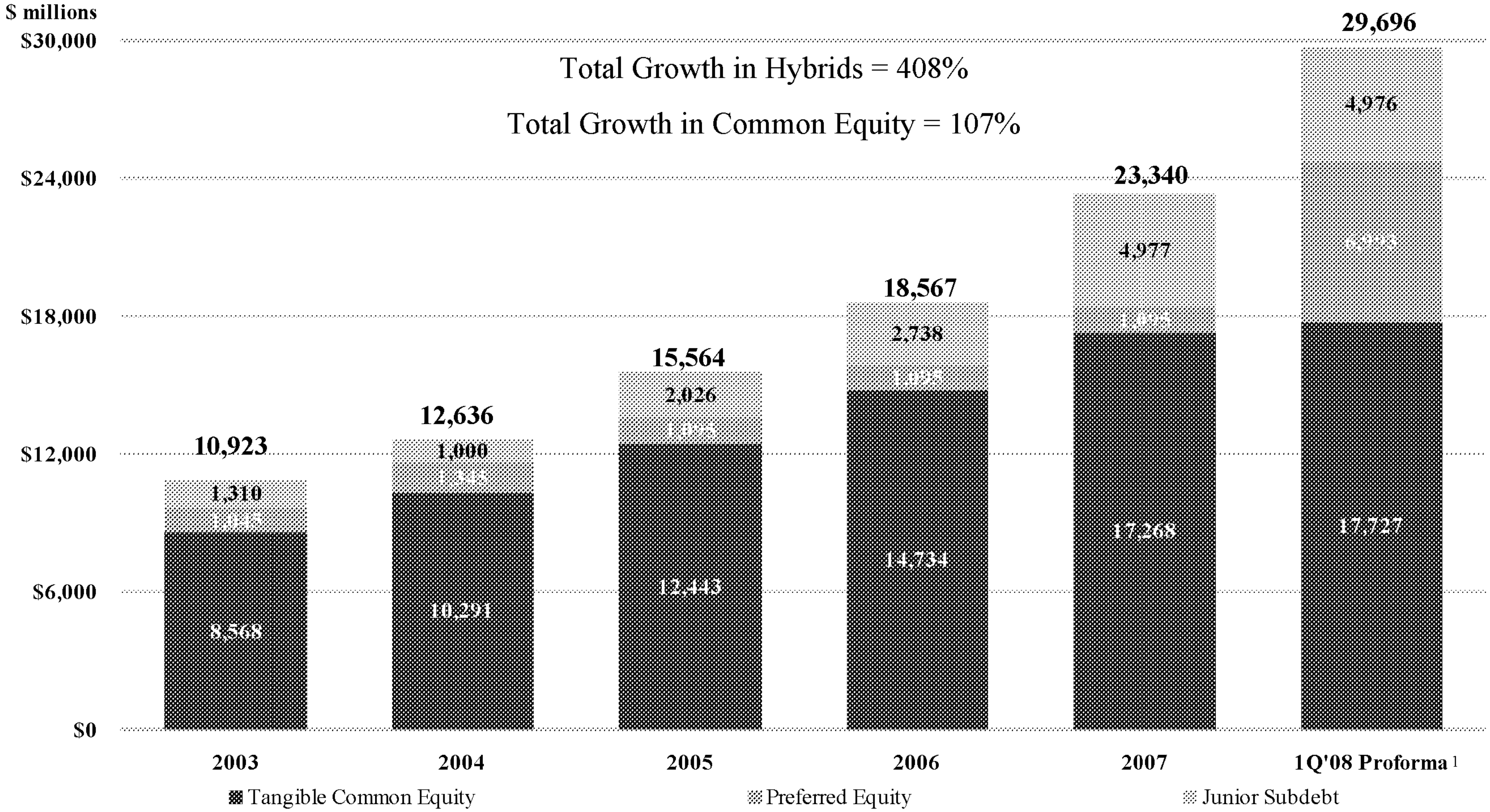
**$2.0 B Subordinated Debt**

- Issued in May 2008
- Coupon of 7.50%, 30-year maturity
- Subordinate to Senior Debt
- Included as CSE Equivalent Tier 2 Capital
- $4.0 billion of orders within one hour

# … Have Helped Lehman To Grow Its Equity Base…

**The Firm has consistently raised equity capital on a proactive basis when markets were opportune**

## Total Equity Capital



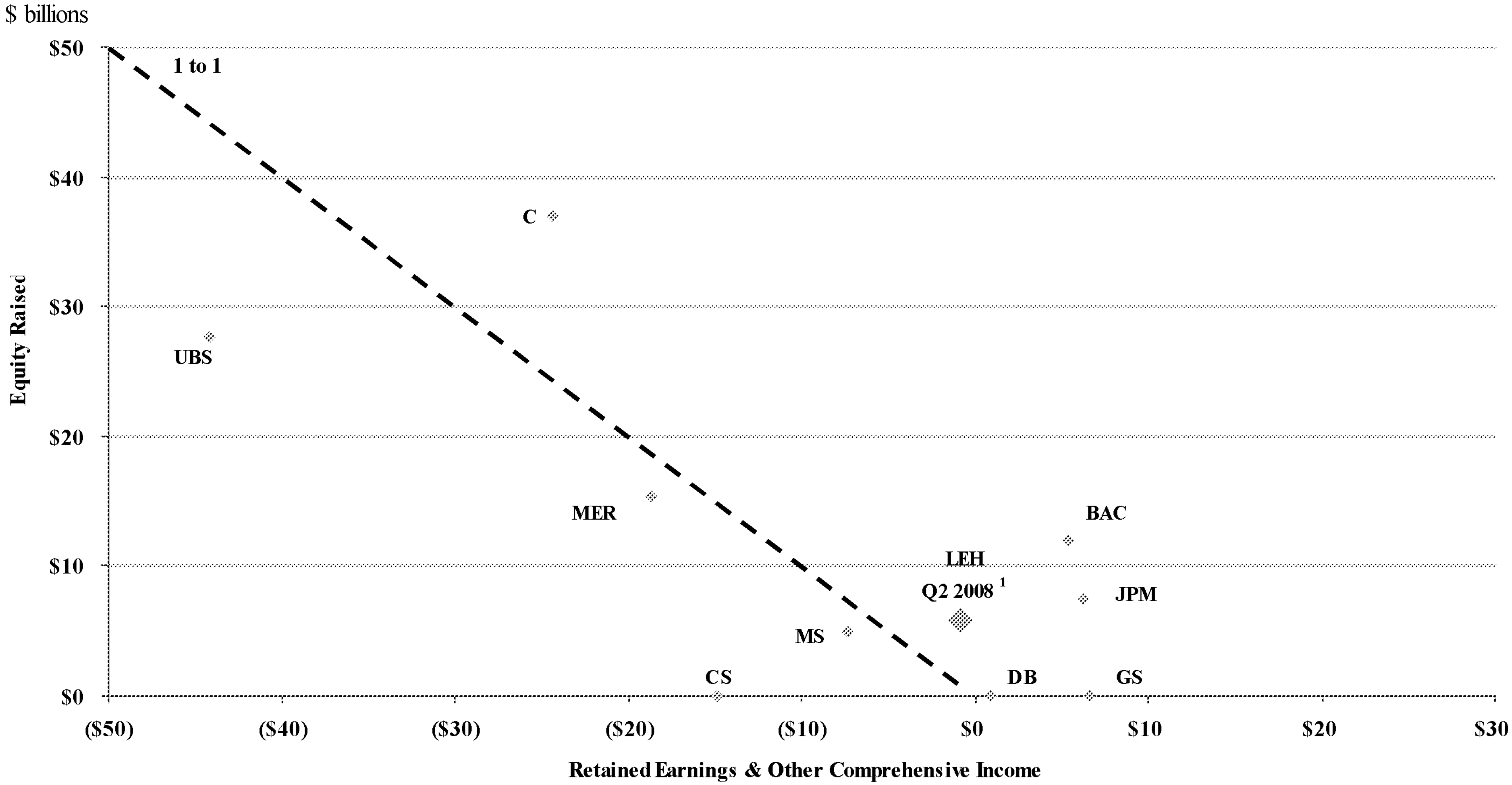

1. *Includes $4.0bn of preferred issuance*

# …And Will Allow the Firm to Weather Q2 '08 Writedowns

**By proactively raising capital when markets were attractive, Lehman has adequate equity to cover depressed earnings during the current downturn**

- Our proforma position will look even more attractive given that our peers will likely experience the same technical divergence that Lehman has in the second quarter

**Equity Raised versus Retained Earnings and Other Comprehensive Income Q3 '07 to Q1 '08**




*1. LEH Q2 '08 data point includes a conservative projected loss of $(2.2)B in Retained Earnings and Other Comprehensive Income*

# Lehman Is Strongly Capitalized By Any Measure

**To monitor equity adequacy, the Firm use three measures: Net Leverage, CSE Total Capital Ratio, and our internal Equity Adequacy Framework**

- All three measures reflect that the Firm is currently well capitalized

### Net Leverage

- Accounting ratio that measures the value of assets supported by $1 of equity
  - Component of ROE
- Does not account for different risk/liquidity characteristics of assets
- Heavily quoted by journalists and analysts

**Q1' 08 Proforma[1]**: Net Leverage = 13.4x

### CSE Capital Ratios

- Measures by which regulators determine whether a bank is adequately capitalized
  - Tier 1 and Total Capital Ratio
- Account for on- and off-balance sheet assets with different risk profiles
- Will begin reporting externally in Q2' 08

2008F Total Capital Ratio = 18.2%

### Equity Adequacy Framework

- Multi-factor model that determines the Gross Equity (Common Equity + Hybrid Equity) requirement
  - Additive charges for Trading, Counterparty, Operational, Liquidity, and Corp Assets
- Accounts for off-balance sheet assets with different risk profiles
- Liquidity component will be charged to businesses

2008F Surplus = $4.4 B[2]

1. *Q1' 08 Proforma includes $4.0 B in Non-cumulative Perpetual Preferred issued in April*
2. *Includes Target Surplus of $1.5B*

# Targeted Reduction in Q2 ’08 Balance Sheet…

**In an effort to reduce Q2 ‘08 leverage ratios, the Firm is undergoing a deleveraging exercise which will be driven by specific balance sheet reductions coupled with capital raising**

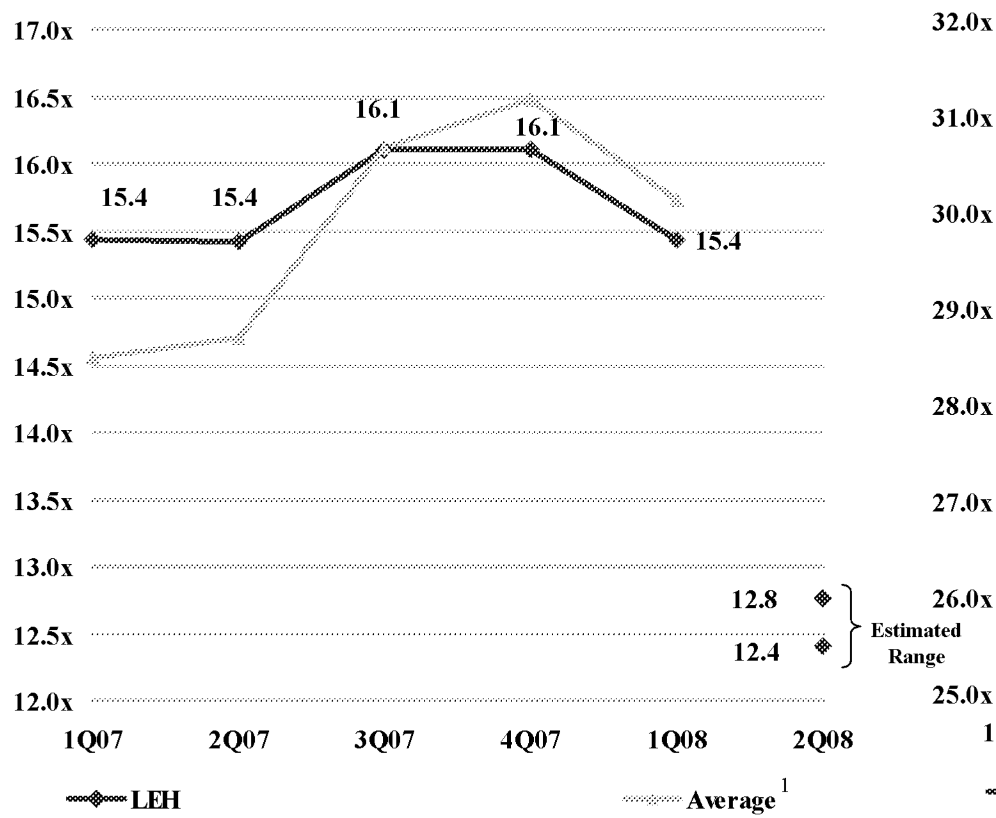
**Gross and Net Balance Sheet**

| | | *Estimated Range* | | | *Estimated Reduction* | | |
|---|---|---|---|---|---|---|---|
| $ billions | **Q1' 08** | **Q2 ' 08** | | | **Q2 '08 vs. Q1 '08** | | |
| Net | 396 | 346 | - | 356 | *(40)* | - | *(50)* |
| Gross | 786 | 686 | - | 711 | *(75)* | - | *(100)* |

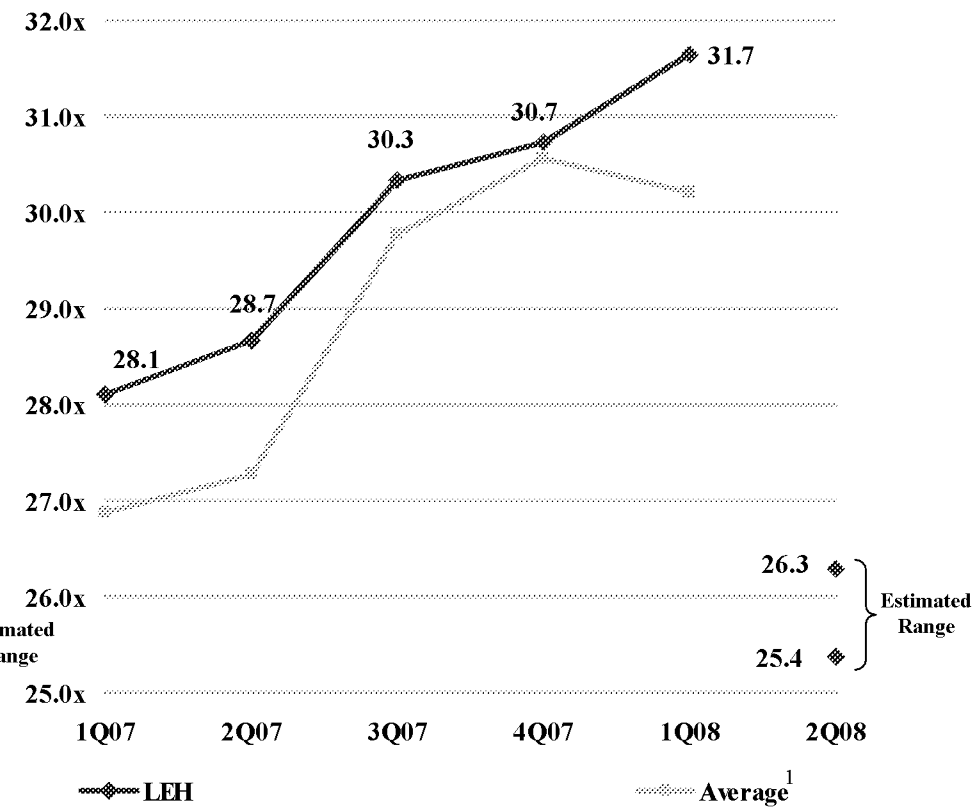
# …Will Reduce Leverage In Combination with Capital Raises

**Even after adjusting for the impact of the projected Q2' 08 loss of $2.0 billion, Lehman's leverage ratios will be lower in Q2 '08 than in Q1 '08**

## Net Leverage




## Gross Leverage

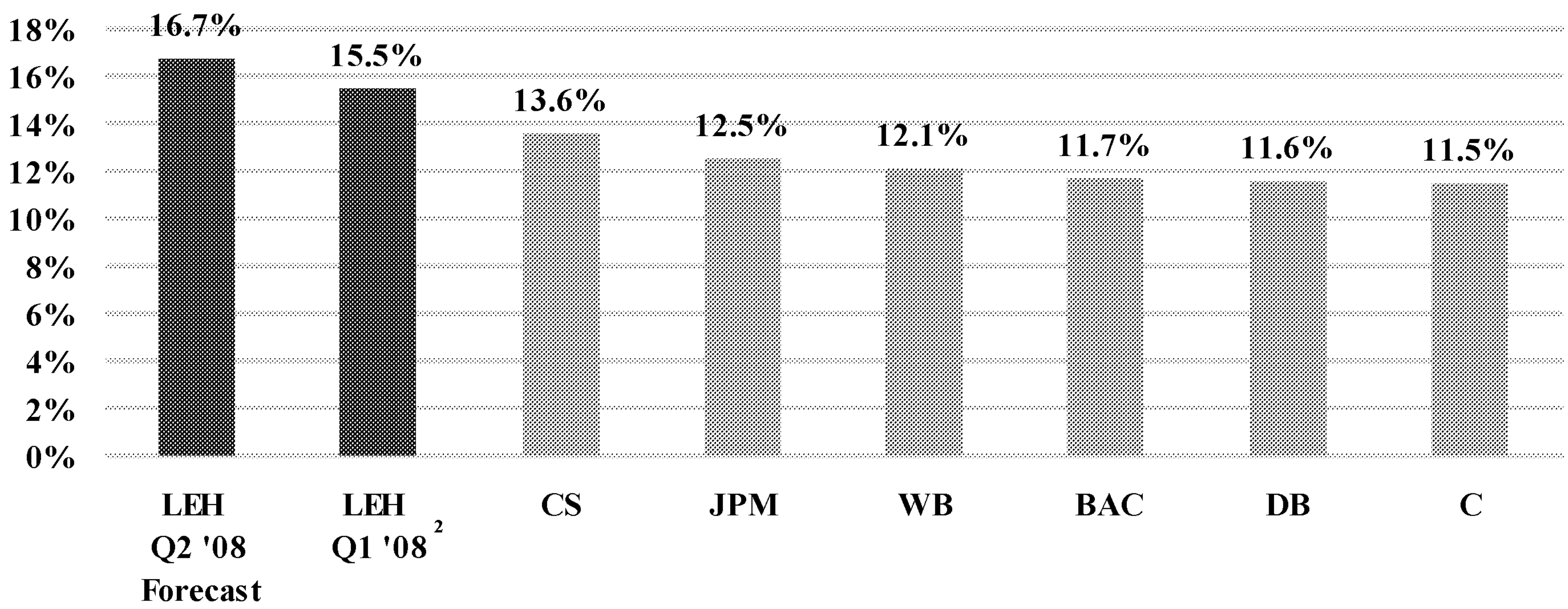



1. *Average includes GS, MS, MER*

# CSE Capital Ratios Also Look Strong

**The Firm has made a conscious decision to shore up its capital base and maintain a Total Capital ratio under the CSE regime above that of the major Commercial Banks' equivalent Total Capital Ratio under Basel II**

Total Capital Ratio[1]



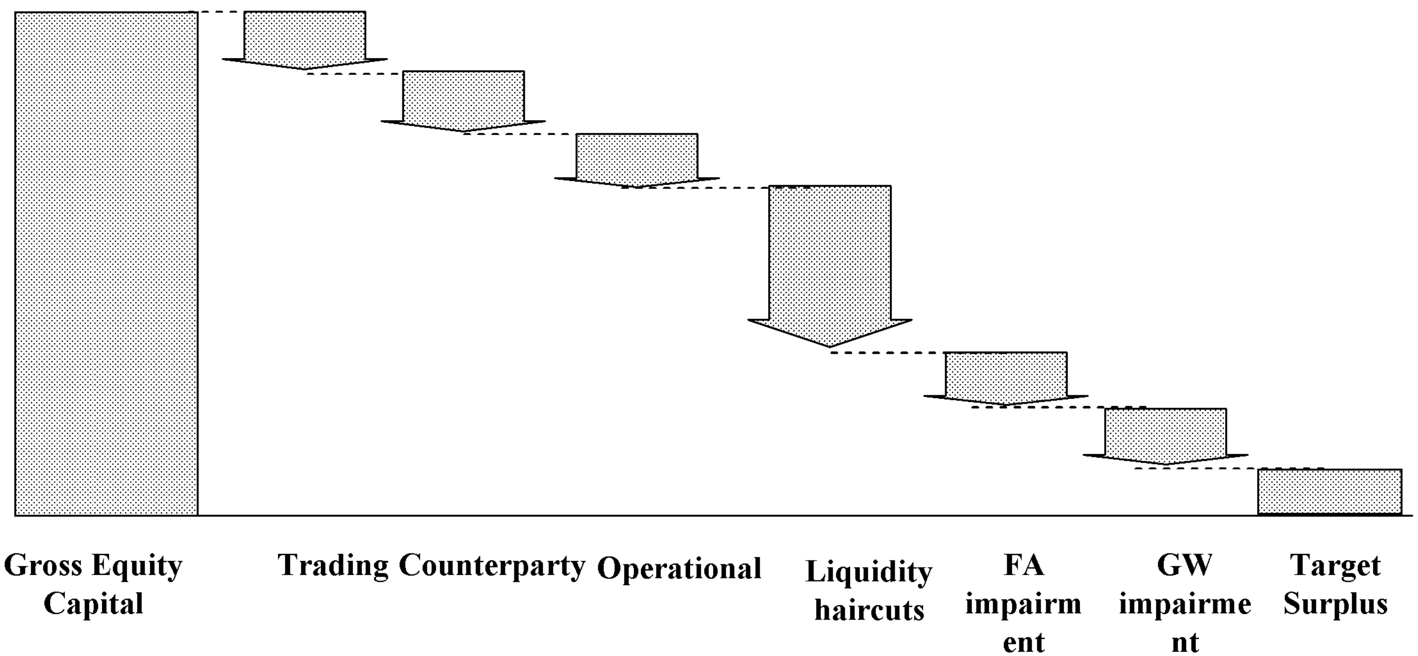

1. *All Banks' ratios are as of Q1 '08 per their Earnings press releases*
2. *Updated for approved SEC Methodology*

# Lehman's Equity Adequacy Framework (EAF)…

**The Equity Allocation framework (EAF) calculates the equity required to enable restructuring in crisis outside of bankruptcy without access to unsecured debt.**

- The model incorporates both risk and liquidity considerations and can be applied at different levels of granularity, including the Firm, Divisions, BPMs and even trades

## Equity Compression in Crisis




**Available Equity** | **Required Equity**

$$\left\{ \text{Common Equity} + \text{Hybrid Equity} \right\} - \left\{ \text{Trading} + \text{Counterparty} + \text{Operational} + \text{Less-Liquid} + \text{Impairment} + \text{Target Surplus} \right\} \geq 0$$

# …Also Highlights Lehman's Stong Capital Position



## At the end of Q1' 08, the Firm had an equity surplus of $4.4B billion, or $2.9 billion over the Target Surplus of $1.5 billion

### Q1' 08 Equity Adequacy Framework Surplus/(Deficit)

| *Variables in $mm* | |
|---|---|
| **Performance data** | Q1' 08 - F |
| VaR 95% 1 day | 122 |
| Counterparty Risk Appetite | 367 |
| Less Liquid Assets | 174,597 |
| Revenue | 19,257 |
| PP&E | 3,861 |
| GW&I | 4,127 |
| DTA | 2,309 |

| *Variables in $mm* | |
|---|---|
| **Equity Required** | **Q1' 08 - F** |
| Trading | 3,997 |
| Counterparty | 772 |
| Less Liquid Funding Haircuts | |
| *Less Liquid assets* | *17,671* |
| *Fixed assets* | *2,902* |
| *Goodwill* | *1,227* |
| *DTA* | *1,847* |
| Total | 23,647 |
| Operational | 963 |
| **Total Gross Equity Required Before Target Surplus** | **29,379** |
| Target Surplus | 1,500 |
| **Total Gross Equity Required** | **30,879** |
| **Gross Equity Available** | |
| Common Equity | 21,839 |
| Hybrids/Preferred[1] | 11,969 |
| **Total Gross Equity** | **33,808** |
| **Surplus/(Deficit) Before Target Surplus** | **4,429** |

1. *Less Liquid Assets include off-balance sheet items like commitments*
2. *Includes $4.0B Non-cumulative Perpetual Preferred issuance in April*

# Lehman's Current Ratios Stronger Than In the Past [TBU]



## Lehman's current capitalization ratios are stronger than they were when [Moody's/S&P] upgraded Lehman to [A1/A+] in October of [2003/2005]

- Insert chart showing how Lehman's current financial ratios (as measured by the agencies) compare to when Lehman was upgraded in 2003 and 2005. Goal is to show that our current ratios are stronger than they were back then (not sure if this is what we will show but that is the hope).

# Liquidity [Also can replace and/or supplement with pages from Robert's recent S&P Liquidity presentation]

# Building A Liquidity Fortress

- Thanks to its conservative funding framework, Lehman Brothers entered the week of March 17th in a strong liquidity position
  - Liquidity pool of $30 billion
  - Cash capital surplus of $5 billion
  - ~$15 billion overfunding in the repo book - ~$7 billion of which in high yield securities
  - Average tenor of repo book of 24 days (excluding Governments and Agencies)

- Since then, we have taken significant measures to strengthen our liquidity position further
  - Started an active program of deleveraging, discussed previously, which is projected to free up ~$5-10 billion of cash capital
  - Raised $9.5 billion of cash capital through preferred, subordinated and senior debt issuances, which, coupled with the deleveraging effort, essentially completes our debt issuance requirement for the year (1)
  - Increased overfunding in the repo book to $18 billion - $8 billion of which in high yield securities
  - Grew the average tenor of repo book of 29 days (excluding Governments and Agencies)
    - 37 days excluding collateral that can be pledged to the Federal Reserve or ECB

- We project finishing this quarter with a $40 billion liquidity pool and a $10 billion cash capital surplus

# 2008 YTD Liquidity Developments

**In addition to the capital trades, the Firm continues to strengthen its liquidity profile through notable, high demand, issuances and securitizations**

**$2.5B Senior Debt**

- Issued in April
- Priced at initial guidance of T+320
- 10-year maturity
- $6.5 billion of orders within 1 hour

**£ 0.5 Senior Debt**

- Issued in April
- Priced at initial guidance of G+315
- 10-year maturity
- £0.8 billion of orders within 4 hours

**$2.0B Unsecured Facility**

- Renewed in March
- Achieved favorable pricing at L+60bps all in
- 3-year maturity
- Oversubscribed and included 40 banks

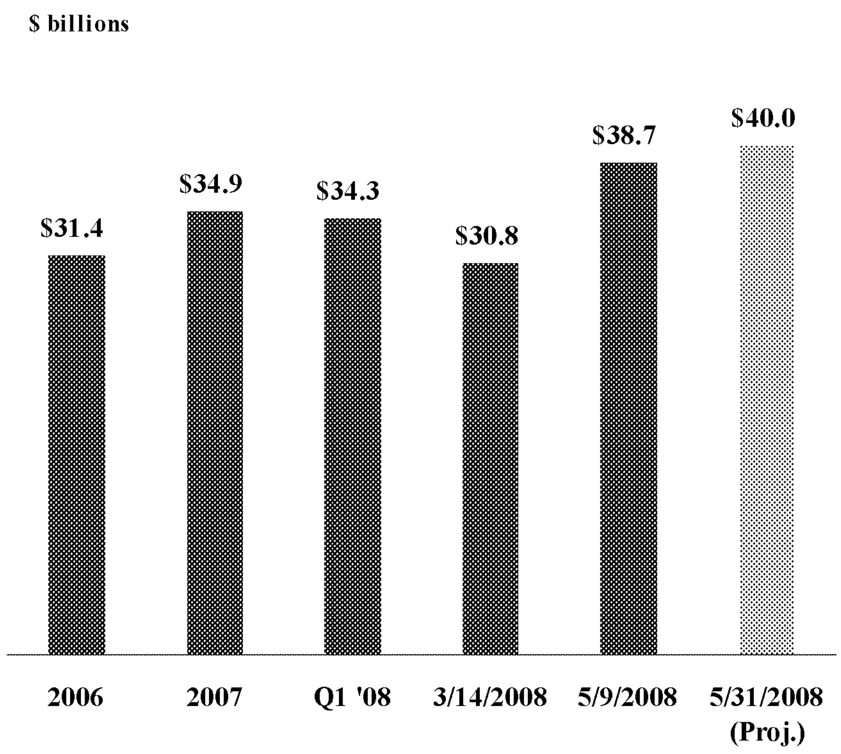
**CLO Securitizations**

- $2.8 billion Freedom CLO ($2.2 billion Fed-eligible)
- $1.9 billion Spruce CLO ($1.5 billion Fed-eligible)
- $2.4 billion (USD equiv) Thalia CLO ($1.1 billion ECB-eligible)

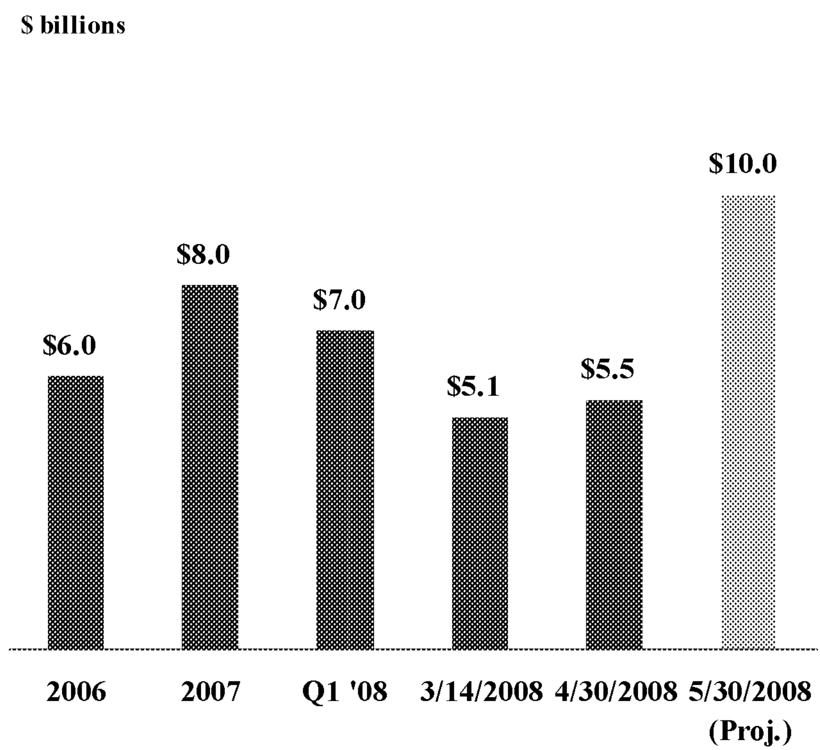
# Liquidity Pool And Cash Capital Surplus

**Since 2006, Holdings' liquidity pool and cash capital surplus have fluctuated in a range of $30-35 billion and $6-8 billion, respectively. We project ending the quarter with a $40 billion liquidity pool and a $10 billion cash capital surplus**

Liquidity Pool




Cash Capital Surplus



# Secured Funding

- We mitigate secured funding risk by overfunding or term-funding at-risk asset classes (high yield corporates, asset backed securities). The overfunding used to be around $10-15 billion but has lately increased to $15-20 billion – more than half in non-Central Bank eligible collateral – primarily high yield corporates
- We also increase the average tenor of the repo book from 20-25 days to 25-30 days (35-40 days for collateral that cannot be pledged to the Federal Reserve or the ECB)

**Non-Traditional Repo Book Metrics[1]**

| | 29-Feb | 4-Mar | 14-Mar | 2-Apr | 2-May | 3/14 - 5/2 Change |
|---|---|---|---|---|---|---|
| Repo Book ($ Billions) | | | | | | |
| Allocated Collateral | 116.4 | 114.0 | 115.3 | 108.3 | 111.7 | -3% |
| Overfunding | 9.2 | 14.6 | 12.7 | 18.0 | 17.5 | 38% |
| **Repo Capacity** | **125.6** | **128.6** | **128.0** | **126.3** | **129.2** | 1% |
| Average tenor (days) | | | | | | |
| Grand Total | 25 | 22 | 24 | 25 | 29 | 21% |
| *Central Bank Eligible Collateral* | | | | | *23* | |
| *Non Central Bank Eligible Collateral* | | | | | *37* | |
| % Repo Book With Maturities <= 1 Week | 58% | 58% | 57% | 52% | 54% | -3% |

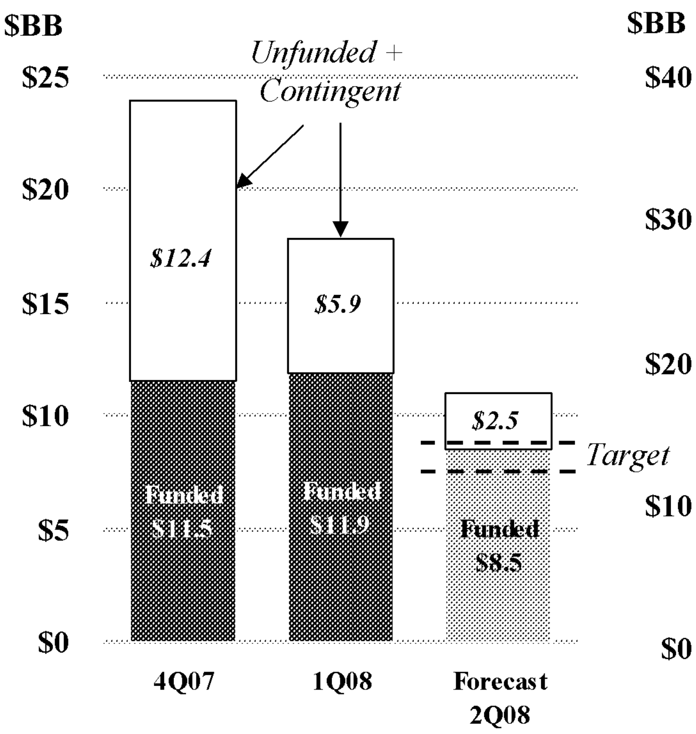
1. *Repo book excludes Governments, Treasuries, Government/MBS Agencies, Sovereigns*

# Risk

# Lehman Active in Reducing Its Risk Positions…

**Lehman Brothers is on track to reduce the Firm's key Risk positions in the Fixed Income arena**

## High Yield Acq Financing

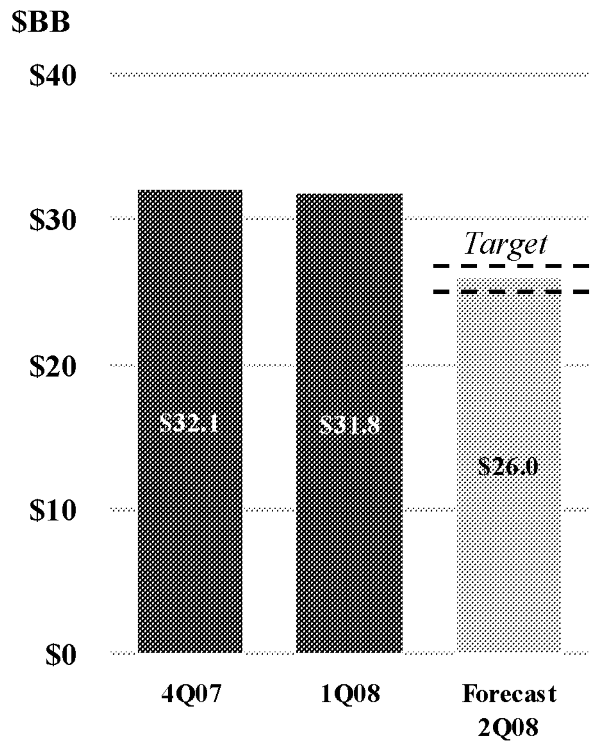



- Steady progress in US; Europe is still challenging
- Non-traditional buyers account for 73% of sales in 2008

## Commercial Mortgages


- Includes whole loans & securities in ~ 70 : 30 proportion
- Non-traditional buyers account for 15% of sales in 2008

## Residential Mortgages

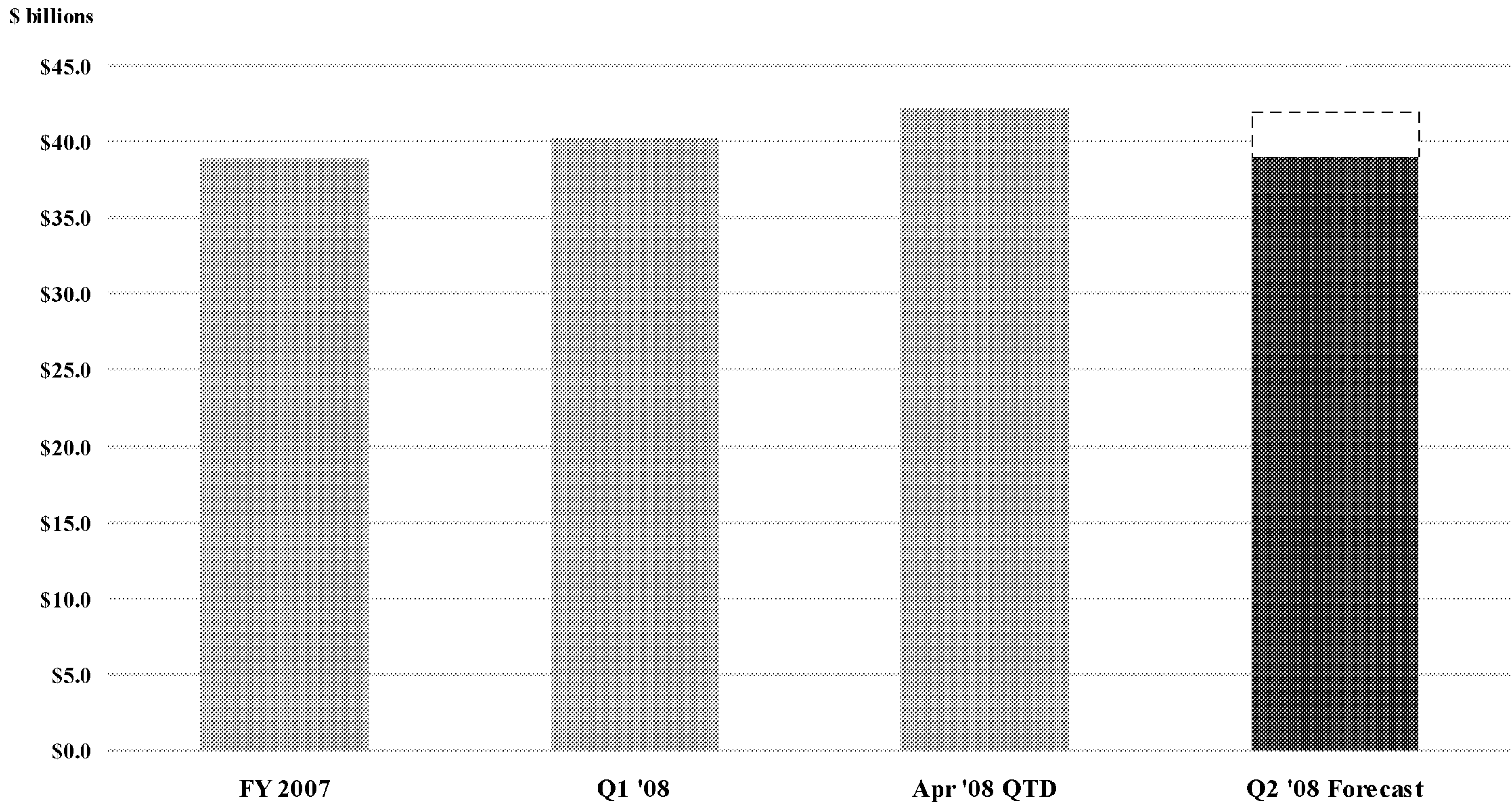



- Includes whole loans & securities in ~ 40 : 60 proportion
- Took on board $4 BB of risk from Peloton

# …While Maintaining Strong Asset Quality

**Lehman's Level 3 Assets have remained relatively stable through the downturn**

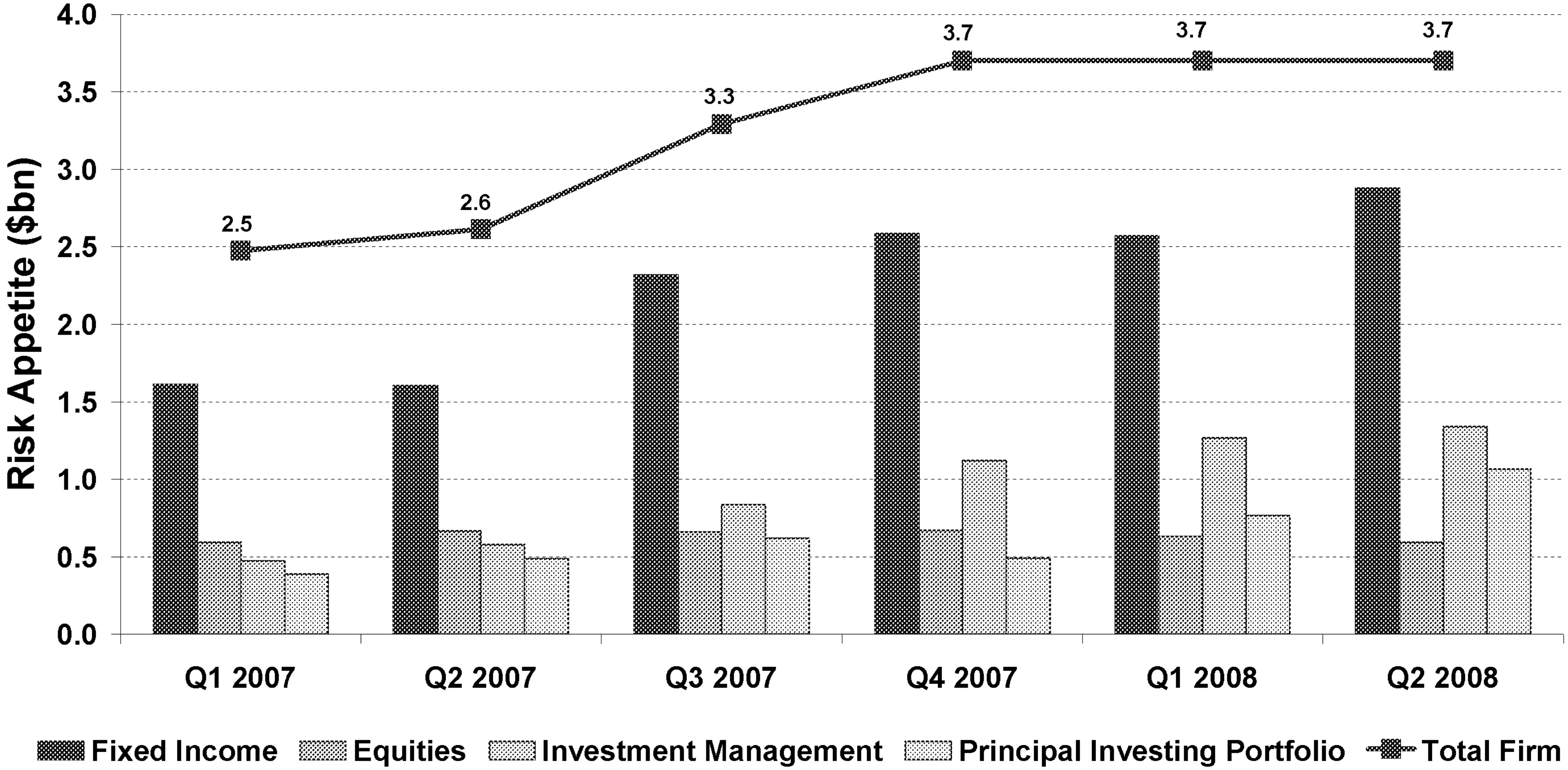
Q2 '08 Level 3 Movements



# Risk Appetite Remains Stable…

**Risk Appetite usage in Q2 '08 was flat relative to Q1 '08 despite position reductions due to higher volatilities in the market**

Average Risk Appetite Usage



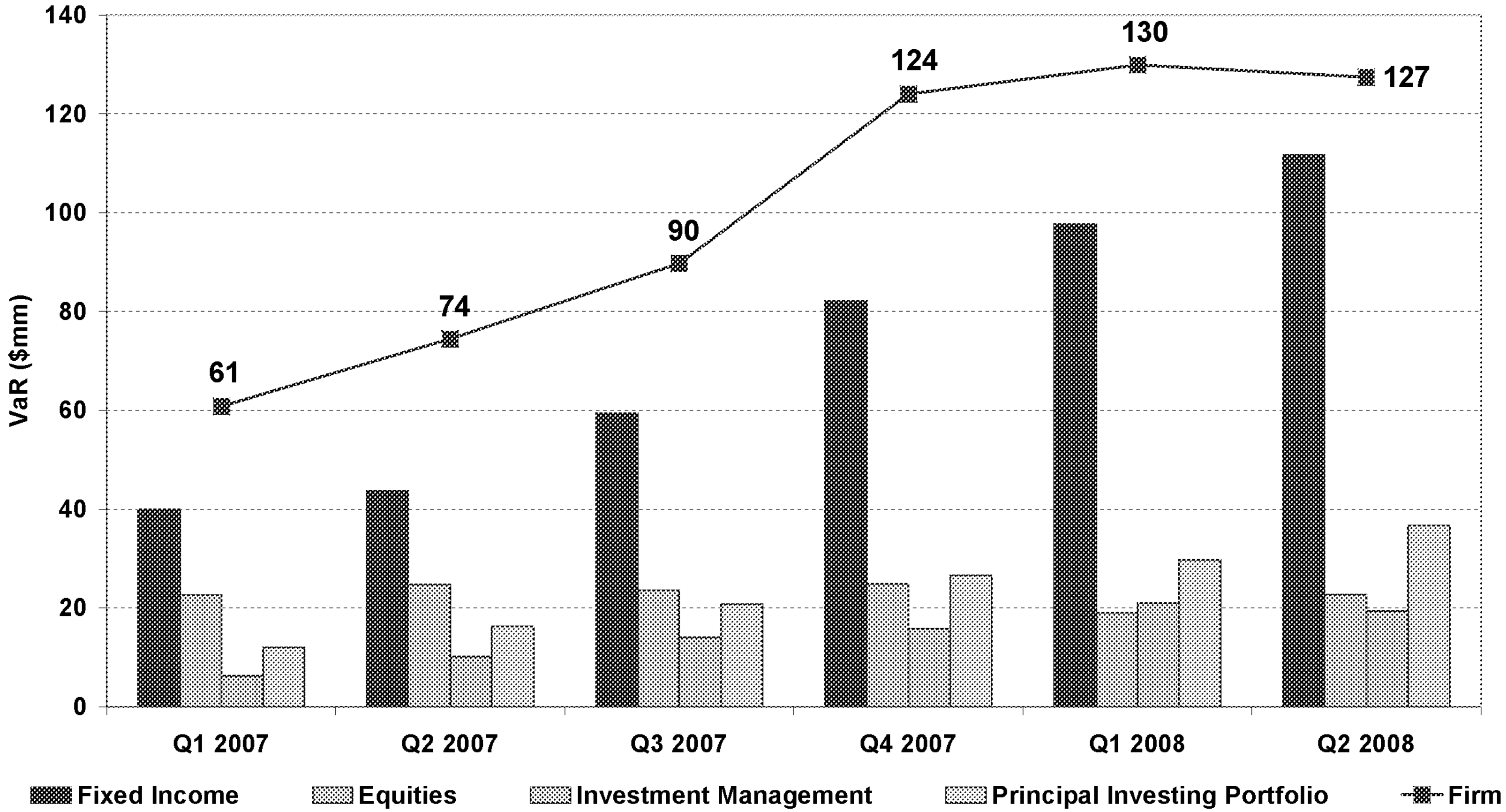

*Note: Q2 '08 results are for quarter-to-date through April 28, 2008.*
*Firm total is less than the sum of businesses due to "diversification benefit," resulting from risk across businesses not being 100% correlated*

# …While VaR Has Decreased Slightly

**VaR decreased slightly in Q2 ’08 as a result of a position reductions and increased portfolio diversification, despite higher volatilities in the market**

◆ These results demonstrate that Lehman’s risk profile did not contribute to its Q2 ’08 revenue decline

Average VaR Usage




*Note: Q2 ‘08 results are for quarter-to-date through April 28, 2008.*

# [Add Additional Slides from O'Meara/Goodman

- Focus will be on Lehman's effective risk management practices and answering specific questions that Moody's sent to us late last week

*Note: Q2 '08 results are for quarter-to-date through April 28, 2008.*

# Conclusion

**Lehman's strong performance through the first three quarters of the economic downturn has been enhanced by our proactive approach to addressing the deteriorating market environment**

– Insert time line chart showing all of the proactive actions that Lehman has taken over the past 1 to 1.5 years to deal with this downturn. Goal is to show that Lehman has been more proactive (rather than reactive) in dealing with these market issues, especially when compared to many of our competitors.

- Due to an unexpected breakdown in the effectiveness of hedges designed to counteract asset writedowns, Lehman will report a Q2 '08 loss despite the continuing strength of its underlying client franchise
  - Lehman's total earnings over the entire duration of the downturn will remain positive
  - Lehman's customer franchise continues to thrive as client revenues remain strong
  - Gross asset writedowns have declined from Q1 '08
  - Lehman has significantly strengthened both its capital and liquidity positions since the end of Q1 '08
  - Lehman has reduced its exposure to risky assets while maintaining a stable level of risk exposure despite an increasingly volatile market
- Once the market understands that the unique breakdown in hedging efficiency drove Q2 '08's adverse results, it will recognize that Lehman is well-positioned for the remainder of 2008

# Appendix

# Parameters of Equity Adequacy Framework (EAF) Model



| Component | Includes | Approach |
|---|---|---|
| **Trading Loss** | • Market Risk<br>• Credit Risk | • VaR-driven<br>• Reflects maximum loss over 1 year holding period with 99.97% confidence level |
| **Counterparty Loss** | • Financing and derivative exposure | • MPE (Probability of default and expected recovery in default) |
| **Liquidation Loss** | • Liquidity Haircuts on LLA's | Triangulated based on<br>• Estimated discount in fire sale<br>• Haircut for non-recourse financing<br>• Equity requirement in CDO structure |
| | • Devaluation of Fixed assets | Estimated by marking to market, then taking same haircuts as on illiquid assets |
| | • Devaluation or loss of intangible assets | Estimated by marking "Separable" assets to market, then taking same haircuts as on Corporate Investments |
| **Operational Loss** | • Operational loss<br>• Litigation loss | • Percent of revenues |
| **Target Surplus** | • Protection against unexpected<br>• Reserve for tactical opportunities | • $1.5 B |