

## **Current Market Background Information**

Draft Aug 16, 2007 - 5 pm

### **Strong Liquidity Management**

- The Firm's liquidity management has been recognized by rating agencies and the SEC as the best in class
- Lehman maintains among the most conservative liquidity profiles of any broker dealer and has in place sufficient funding capacity to meet all current and expected liquidity requirements, even in a stress liquidity environment
  - Following the market dislocation in 1998, we established a sophisticated Funding Framework designed to mitigate liquidity risk through a combination of longer-dated issuance and access to multiple separate liquidity pools
    - We eliminated any reliance on short term debt
    - We established 3 insured, deposit taking banks which collectively have raised \$21.7B in customer deposits and are generally insulated from company and market-specific liquidity events
    - We increased our debt issuance outside the U.S. market to broaden our investor base such that by Q2 2007, 53% of our long term debt was issued outside the U.S.
    - We increased liquidity available to the Holding Co. to cover expected cash outflows for 12 months in a stressed liquidity environment. As of Q2 2007, this liquidity pool stood at \$25.7B and excluded \$4.5B of undrawn unsecured committed facilities
  - As a result, we have among the strongest liquidity profiles of the major broker dealers
    - Firm's liquidity pool is sufficient to cover over 100% of short-term funding needs (up to 1 year), as well as a further \$2B of cash available to opportunistically buy back debt or equity
    - Our Holding Co. liquidity pool stood at \$27B (which excludes the trapped cash and collateral that exists in our regulated broker dealer chain)
    - Through July 2007, we have raised \$52B in debt issuance and a further \$15B in bank facilities. Included within our issuance was \$5B on a single day - our largest ever issuance day - all of which has left us with a tremendously strong overall liquidity and capital base
    - Even in the current environment, the Firm is able to raise long term unsecured debt through the issuance of \$300M/week on average structured notes
    - In addition to the bank funding, we have established pre-funded conduit structures that have the capacity to accept over \$10B of our High Grade and High Yield contingent commitment loans

### **Sub-Prime Exposure Under Control**

- Our exposure to sub-prime is closely controlled and limited
  - Over the past six quarters, sub-prime has accounted for less than 3% of total Firm revenues
  - Even with the deterioration in the mortgage market during Q1 and Q2, we still reported two record quarters in 2007
- In all areas of the sub-prime business, we aggressively manage our exposures

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- In securitization business, our strategy is to minimize exposure by selling, to the extent possible, all tranches of securitization
  - The non-IG sub-prime retained interests, which are the riskiest tranches of securitizations, remain well-contained and hedged, and predominantly represent balances from recent securitizations
  - In our CDO/CLO business, the Firm retains the exposure only as long as necessary to complete the structuring. We retain no residual exposure
- We aggressively employ derivative hedges
  - When the Firm is exposed to potentially adverse price movements, we proactively hedge the exposure by using off-balance sheet derivatives
  - As a result, our economic exposure is substantially lower than the balance sheet position
  - To date we are pleased with the success of our hedging strategy
- Limited counter-party credit exposure due to:
  - Substantial over-collateralization of credit lines
  - Daily margining
- Sufficient liquidity
  - Funding is managed via 2 Lehman banks which have access to their own sources of liquidity, thus minimizing funding requirements for the Holding Co.
- We have revised our origination and underwriting standards as the market has evolved, with credit standards significantly tighter than in 2005-2006

### **Leveraged Lending**

- We disclosed \$44B of High Yield Contingent Acquisition Commitments at May 31, 2007, up from \$20B at February 2007, and \$13B at November 2006
- Many of the commitments in place at May 31 have since come off, including deals that were completed in the market
- The loan market has been open, but choppy. A number of deals have gotten done, but the larger deals have been hung, as full order books have not been built
- We are in a liquidity position to fund all of our commitments even if there is no market to syndicate them
- We have been marking commitments to market, and have taken a loss of \$474M (inclusive of hedge gains)
- We expect the commitment amount to be substantially lower at the end of Q3 (\$25B to \$30B)
- The issues in the market right now do not relate to deteriorating credit fundamentals, but to a repricing based on investor appetite. Supply/demand imbalances favor investors
- Price flex and MACs provide additional protection against unforeseen changes in the business environment

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- Any newer deals we have committed to have more favorable terms in terms of rates, flex and covenants which will enable us to syndicate them effectively
- These transactions represent a diversified pool of high-quality credits which appeal to different investor types. The current portfolio of ~40 transactions is diversified by industry, geography and type (corporate, real estate, whole business securitization)
- These transactions were approved by the Firm credit committee, subject to a rigorous review process, including single transaction limits [15% of regulatory capital – for internal purposes only]
- Each of these transaction types appeals to a different type of investor, enhancing our ability to syndicate the portfolio
- Many of our largest commitments are not scheduled to close in the next several weeks, but out into September, October and November
- We are seeing significant pools of capital prepared to buy huge amounts of these loans/commitments at depressed prices, so we know there is a floor bid
- Based on these bids, we are comfortable that our P&L exposure is manageable
- Some portion will be funded in our deposit taking banks, some in pre-funded long-tem secured lending facilities, and some from the Firm's Holding Co. liquidity position
- Over the past 4 quarters, Leveraged Finance (fees earned on financing) accounted for approximately 4% of the Firm's Net Revenues

### Strong Global Franchise

- We have a diversified, global franchise with leading positions in many of the most rapidly growing, highest margin products / regions. This creates the platform for us to deliver sustained, long-term revenue growth across a wide variety of market environments
  - Broad-based, diversified, global platform
    - Four main business lines, each of which generate at least \$3B in annualized Q2 revenues
      - Fixed Income \$1.9B (34%)
      - Equities \$1.7B (31%)
      - IBD \$1.2B (21%)
      - IMD \$0.8B (14%)
    - Large, rapidly growing non-U.S. franchise, generating almost half of the Firm's revenues
      - 48% of Q2 revenues earned from non-U.S. sources
        - vs. GS (52%), ML (42%), MS (42%), BSC (20%)
      - Non-U.S. revenues up 30% from Q1, significantly more than peer group (0% average increase Q-on-Q)
      - Reflects significant investment we have made in building our capabilities in most rapidly growing markets, globally

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- Leading position in many rapidly-growing, high-margin businesses globally

- Top 10 Investment Banking franchise

<b>H1 2007 Volume</b>	<b>LEH</b>	<b>BSC</b>	<b>LEH share/BSC share</b>
M&A (announced)	#5	#30	9x
High Yield	#7	#12	~ 2x
ECM	#9	#19	~5x

- Top 10 position in Equities

- Top 6 in U.S. Cash and Derivatives

<b>June YTD Volume</b>	<b>LEH</b>	<b>BSC</b>	<b>LEH share/BSC share</b>
NYSE Trading	#4	#12	2.5x
Nasdaq	#4	#8	1.7x
Deriv (Greenwich '06)	#4	#11	NA

- #1 Equity research by *I.I.*; 4 years running
- Top 1 or 2 in major European cash markets
  - #1 in LSE (13.4% volume share, June YTD '07)
  - #2 in Euronext (8.3% volume share, June YTD '07)
  - #2 in Deutsche Bourse (Xetra; 7.3% June '07 volumes)

- Leading Fixed Income franchise

- #1 ranked U.S. FI dealer (2007 Greenwich survey)
  - #1 sales quality (2006 Greenwich survey)
  - #1 trading quality (2006 Greenwich survey)
  - #1 market penetration (2006 Greenwich survey)
  - #1 FI research franchise by *I.I.*, 7<sup>th</sup> year in a row

- Large, rapidly growing Investment Management franchise

- \$263B in total AUM (up from \$12B in 2001)
  - More than 4x larger than BSC (\$60B)
- \$26B in alternatives AUM (up from \$6B in 2001)
  - Stakes in several of the largest, most stable, most profitable global hedge funds (DE Shaw, Ospraie)

- Strength and breadth of global platform has enabled us to achieve record net revenues and earnings while maintaining strong profitability, even in challenging environments