FINAL TRANSCRIPT

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LEH - Q2 2008 Lehman Brothers Holdings Inc. Earnings Conference Call

Event Date/Time: Jun. 16. 2008 / 10:00AM ET

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PRESENTATION

Operator

Good morning and welcome to the Lehman Brothers second quarter earnings conference call. At this time, all participants are in a listen-only mode. After our prepared remarks, there will be a question-and-answer session. (OPERATOR INSTRUCTIONS) Today's conference is being recorded. If there are any objections, please disconnect at this time.

I would now like to turn the call over to Mr. Ed Grieb, Director of Investor Relations. Sir, you may begin.

Ed Grieb - *Lehman Brothers Holdings Inc. - Director, IR*

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, the 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 the 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 selected statistical information, reconciliation of average stockholders' equity to average, and leverage and net leverage calculation in this morning's earnings press release which has been posted on the Firm's website www.lehman.com and filed with the SEC in a Form 8-K available at www.SEC.gov. This morning we will review our second quarter earnings which are not materially different from those in our prerelease last Monday. I'm joined this morning by Dick Fuld, Chairman, Chief Executive Officer; Bart McDade, President, Chief Operating Officer; and Ian Lowitt, Chief Financial Officer. At the conclusion of the prepared comments the three will be available to field questions that you may have. I'll now turn the call over to Dick Fuld.

Dick Fuld - *Lehman Brothers Holdings Inc. - Chairman, CEO*

This is clearly Ian's presentation but I wanted to make some remarks as part of today's earnings call. Let me just begin by saying that I am very disappointed with these financial results. We lost $2.8 billion for me, all I can say is that's just totally unacceptable. This is my responsibility. And I wanted you to hear a few things from me directly. Let me start with our model.

We're a global institutional investment bank that focuses on our clients. We put our clients in the middle of everything we do. We provide access to the markets for our clients. We advise our clients. We leverage our intellectual capital across the platform to provide best solutions for these clients. We commit capital on behalf of our clients and we commit capital in places where we see attractive risk adjusted returns. Years ago, we made a decision to build out the best-in-class commercial and residential mortgage origination and distribution platforms. We created significant revenues and net income over those years that funded many of the Firm's investments that have diversified our core franchise today. We made active decisions to deploy our capital. Some of which in hindsight were poor choices, because we really didn't react quickly enough to the eroding environment. For example, we accumulated positions in leveraged loans that we believed we could syndicate and clearly not all of those got sold. Together, the accumulation of all these positions ultimately led to our decision this past quarter to aggressively delever.

Now let me discuss our current asset valuation on those remaining positions. I am the one who ultimately signs off and I'm comfortable with our valuations at the end of our second quarter, because we have always had a rigorous internal process. In addition, this quarter we had the benefit of much greater price visibility, due to the number of assets that were sold, especially in the commercial and residential mortgage area, that were the result of our deleveraging and the strong trading volumes and the cash and uncertain derivative markets that gave us important additional valuation information. I have also gotten the message from a number of you on your desire to hear from us more transparency. So I've asked Ian in his presentation to take you through more detail than we have before.

Now let me talk about the management changes that we made last week. Joe Gregory, stepped down from his role as President and Chief Operating Officer. Joe's been my partner for over 30 years and I must tell you, it was one of the most difficult decisions that he and I had to make together. Our new President and Chief Operating Officer, Bart McDade, has been my partner, has been with the Firm for 25 years and is the Firm's best operator. Bart has a proven track record of success in building and leading businesses and fixed income and equities and in banking. This firm is known for its operating excellence and together, Bart and I will restore that reputation.

You also saw that Erin Callan stepped down from her role as CFO. Erin is wonderfully talented. I respect her. And we are having conversations about creating a position that makes sense for her. Ian Lowitt, who has been with the Firm for 14 years, is now our new CFO. He brings significant experience to the position, finance already reports to Ian in his capacity as co-CAO, and as our former Treasurer, he's already well-known to many of our debt and equity investors, our analysts and the rating agencies and I must tell you I have huge confidence in Ian.

Regarding our balance sheet, we reduced our gross assets by $147 billion over the quarter, which exceeded the targets that we set. We also raised $10 billion of tangible equity since the beginning of the second quarter, a pro forma we now have $33 billion of tangible equity, so we're in a position today to support our clients in these challenging markets.

Now let me talk about the make-up of our revenues and talk first about what we've lost. Residential and commercial mortgage origination and the securitization of those products, as far as I'm concerned, near term, those revenues are significantly diminished. Although the secondary trading of those securities is still good. Sponsor and leveraged loan origination businesses, while we're doing deals on better terms, those revenue opportunities I believe will remain weak for the next six to 18 months. But those businesses, taken together, contributed less than 10% of our total 2007 net revenues, which, remember, was a record year and also included net write-downs. We also reduced our resources here because when you look at the 6,000 people that we let go over the last 12 months, a large number of those people bat in those businesses. Those are some of the reasons that I'm confident in the earnings potential of our franchise, even without the contributions from those businesses.

Our core business and our strategy are sound. For many years, we have built a set of businesses that are diversified by product and by region. We have a leading global capital market client franchise, across both equities, and fixed income. Our client revenues are up about 30% year-over-year. We also have investment banking franchise that's growing fee share, most of that coming from increased market share and M&A, in equity and equity related and high grade debt issuance. Our newest pillar, investment management, is winning institutional strategic mandates as $277 billion of assets under management and a high net worth business. So as you can see, our strategy of building a diversified set of global businesses is working.

We have a track record of taking market share, coming out of difficult cycles, and then converting that share into revenues and net income. In addition to all that, within our core businesses, we have a number of growth opportunities, focusing on Asia broadly, in the brick countries, and then globally in our equity flow businesses and the rates and credit flow trading businesses, prime services, in commodities and foreign exchange and private equity. This year, we've already hired about 2700 people and we've redeployed about 1,000 people, many of whom will join those targeted new areas. We're also deploying capital to support these growing businesses. These are good opportunities. The key, the key is to execute.

As all of you know, these are still challenging markets. Our core franchise and our culture are strong. Our capital and liquidity positions have never been stronger. We remain dedicated to our client-driven model. Our goal -- our goal is simple. That's to create value for our shareholders and for our debt holders, for our clients, and for our employees. On many fronts, in this cycle, we did not achieve this goal. This is my responsibility. We've made a number of changes. It's now my job to make sure that we execute. Ian?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

Good morning and thank you for joining us today. We previewed with you--. (Audio difficulties)

Operator

Please continue to stand by.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I'm sorry. I'm going to start over with my remarks. My microphone was off. Thanks, Dick. The microphone's now on. Good morning and thank you for joining us today.

Last Monday's preannouncement call we previewed with you the performance of the Firm during the quarter. These extremely disappointing results raise a number of important questions, which we intend to address today. There are five main topics which I will cover on the call. First, I will briefly review our second quarter earnings as much of this was covered last week. Second, I will talk about the ongoing strength of our client franchise. Third, I will talk about the deleveraging in the quarter and specifically detailed changes in our exposures. As part of this discussion, I will also elaborate on our asset valuation process and discuss certain valuations. Fourth, I will review our capital position. Fifth, I will review our liquidity position and discuss how we strengthened liquidity through the quarter. And finally Bart will be wrapping up for us. So a lot to cover. I'm going to get started.

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 $668 million, and net loss of $2.8 billion a diluted loss per share of $5.14. The markets were impacted this quarter by a significant dislocation in spread movements derivative instruments and cash assets. This quarter we reported gross mark to market adjustments of $3.6 billion, concentrated in our residential and commercial exposures. However, these gross mark-to-market adjustments were 23% lower than the $4.7 billion of gross adjustments recorded in the first quarter. Additionally, this quarter we incurred a net loss of $100 million on our hedges, against these assets, for net mark-to-market adjustments of $3.7 billion. These hedges had provided significant benefits in prior periods. So while our gross mark-to-market adjustments were lower than the first quarter, our net adjustments were more than double the first quarter level of $1.8 billion.

Our principal portfolios also incurred losses of approximately $500 million this quarter, including $300 million recorded in the equity's component of capital markets including our mark-to-market adjustment on our investment in JLG. We had approximately $700 million of losses associated with defensive positioning in our credit and rates businesses. So on a combined basis these asset repricings and losses negatively impacted our revenues by a total of approximately $4.9 billion. That means the remainder of our business generated revenues of approximately $4.2 billion. We believe the $4.2 billion is indicative of the current underlying earnings power of the franchise and was earned in a very challenging market.

I would also note that our aggressive deleveraging this quarter had an impact on our revenues, primarily through shifting focus of our operators. With respect to expenses, for the quarter our total compensation expense was $2.3 billion, a $418 million increase from last quarter. 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 the compensation expense. Our headcount declined by 1900, as we continued to scale our businesses to the respective opportunities. Our non-personnel expenses totaled $1.1 billion for the quarter, in this area we have implemented a number of further cost savings initiatives which we expect will generate approximately $250 million in annualized savings going forward.

I now want to discuss the continued strength of our underlying client franchise. This is -- the easiest way to do this is to review our performance by business segment. In Investment Banking, we posted revenues of $858 million, essentially flat versus the sequential period and down 25% year-over-year. The pretax operating income for the segment this quarter was $193 million, representing a pretax margin of 22%. To put these results in a longer term context, our banking franchise has grown revenue for the past four years by an average of over 20% per year, with peak quarterly revenues of $1.2 billion in the second quarter of last year. Year-to-date, we continue to gain fee share in banking and we believe our fee share has increased from 4.4% in 2007, to 4.8% this year.

The dominant theme this quarter was capital raising in the financial sector, U.S. financials raised a total of $150 billion of equity and hybrid capital in the first five months of 2008 excluding self issuances. We lead managed 37% of this volume including $5.2 billion of new capital for Fannie Mae, $7 billion for Washington Mutual, $1.5 billion for CIT and $1.4 billion for Sovereign Bancorp. 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 from 5.8% this year, from 3.6% in 2007 and we are now number three 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 are ranked number four in U.S. high grade issuance with an 8.5% market share. We lead managed the two largest 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 growing our share of completed deals to 24.4% this year, from 19.4% in 2007. We currently rank number four in the U.S. and number one in Asia, ex Japan, in announced M&A. As of the second quarter, we have advised on three of the top four completed deals and three of the top 10 announced M&A transactions of the year. We are working on some of the largest assignments in the second quarter, including HP's acquisition of EDS, Sprint/NEXTEL's joint venture Clearwire, Liberty Mutual's acquisition of SafeCo and Finmeccanica's acquisition of U.S. defense company, DRS. We also closed the Phillip Morris International spinoff and Carlsburgh's acquisition of Scottish & Newcastle and defended Yahoo against a hostile bid from Microsoft. Together, these market share gains and marquee assignments are evidence of the strength and diversity of our banking franchise.

Turning now to our Investment Management business, this segment is comprised of two businesses, Asset Management, which primarily represents our Neuberger Berman business as well as our private equity and private real estate businesses, and private investment management, which includes our high net worth business. We generated Investment Management revenues of $848 million this quarter, down 12% sequentially, and 10% higher than the second quarter of 2007. The sequential revenue decline this quarter was attributable to a reduction in revenues from our minority stakes in external hedge fund managers. Specifically normal seasonality for certain managers who record much of their annual incentive fee income in January.

Private Investment Management generated record revenues this quarter. Our assets under management were flat this quarter at $277 billion, as net outflows were offset by market appreciation. More importantly, however, net outflows were primarily in lower fee, money market assets while we saw approximately $4 billion of inflows in higher fee-based alternative assets. May's inflows were particularly strong versus March's outflows. The pretax operating income for the segment this quarter was $229 million, representing a pretax margin of 27%.

We have been growing the revenues and margin in this business as part of or diversification and growth strategy. To give you a sense of the rate of growth, from 2004 through 2007, our revenues and AUM grew at compound annual growth rates of 22% and 27% respectively. Our private equity assets have grown over 45% in the past 12 months. And more broadly, new important mandates with Ford Motor Company and Teacher's Retirement System of Texas and other strategic partners speak to our commitment to working with the largest, most sophisticated institutions. Our equity investment performance continues to be excellent, with over 95% of private Asset Management AUM exceeding benchmarks over a one year and three year basis and approximately 86% of mutual fund AUM beating their benchmarks for one year and 75% for a three-year basis. And we've only just started expanding in Europe and Asia. A significant portion of our Asset Management business comes from our acquisition of Neuberger Berman in 2003. Since that time the Neuberger Berman franchise has more than doubled in size and we believe the value of the business significantly exceeds the approximately $3 billion of goodwill we currently have on our books.

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 I noted earlier, our client franchise remains strong. Our business model in Capital Markets is focused on servicing client activity and we have an internal metric for valuing and measuring client revenues. Capital Markets 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 3% from a strong first quarter, and up 14% over last year. To put these results in context, Capital Markets client revenues have grown by an average of 24% per year for the past three fiscal years.

In the fixed income segment of Capital Markets, client revenues for the first half of 2008 grew 40% over the first half of last year, including growth of over 35% in each of our regions. Our second quarter client revenues were down 2% from the first quarter, and up 27% versus last year. Year-to-date, our fixed income trading market share in the U.S. grew to 13.1%, from 12.2% in 2007.

Growth in our fixed income franchise was broad-based, especially in securitized products, municipal, commodity, foreign exchange, high grade credit, interest rates and financing, which are all up significantly versus a year ago. We have also restructured our securitized product unit from an origination based model towards a secondary CMO and distressed asset trading business which had good revenues in the quarter. Our structured credit, commodity and municipal businesses also enjoyed a strong quarter driven by their trading performances. Within equity 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 equities client revenues were down approximately 3% versus both comparable periods. Our equity trading market share grew this year on most major global exchanges including NASDAQ where our trading share increased from 7.7% in 2007, to 8.5% year-to-date. And we remain number one in trading on the London Stock Exchange with over 14% market share. We saw strong client revenue growth this year across both our cash business and our prime broker business, the latter of which generated record 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.

Turning now to leverage, we reduced our gross assets by $147 billion, from $786 billion to $639 billion in the second quarter, and we reduced net assets by 470 billion, from $397 billion to $327 billion. As a result, we reduced our gross leverage from 31.7 times to 24.3 times at May 31, and we reduced net leverage from 15.4 times to 12 times prior to the impact of last week's capital rates, including the new capital, our gross leverage declines by approximately four turns and our net leverage by about two turns. Our deleveraging included a reduction of assets across the Firm, including residential and commercial mortgages, real estate held for sale and acquisition finance.

As you can see on the attachment two of the supplemental package to our press release, we reduced residential mortgage assets to $24.9 billion this quarter, from $31.8 billion in the first quarter, a decline of $6.9 billion or 22%. The securities's portion of our exposure is now $15 billion, a reduction of 18%, from $18.2 billion last quarter. Whole loans are now $8.3 billion as 30% reduction from $11.9 billion last quarter, and servicing is at $1.6 billion. Gross write-downs for the quarter were $2.4 billion, 20% lower than the first quarter. During the quarter, we sold approximately $11 billion of residential mortgage assets and purchased approximately $6 billion for net sales of $5 billion, further demonstrating the very active trading in this asset class this quarter.

On attachment three of the supplement, you will see the composition of our residential mortgage assets. We reduced our our Alt-A assets by 30% to $10.2 billion from $14.6 billion and we also reduced our subprime assets by 30% to $2.8 billion from $4 billion. We reduced European residential assets to $9.3 billion this quarter, from $9.5 billion in the first quarter, and we reduced our gross ABS CDO exposure to $600 million from $900 million and we continue to be hedged in this asset class.

On attachment five of the supplemental package you can see that we reduced our exposure to the combination of the commercial mortgage and real estate held for sale GAAP asset lines to $39.8 billion this quarter, from $49 billion in the first quarter, a decline of $9.2 billion or 19%. We've combined these two categories together, given their very similar characteristics. The whole loans are now $19.9 billion, down 20% from $24.9 billion last quarter. Securities and other are $9.5 billion, a 15% reduction from last quarter's $11.2 billion, and real estate held for sale is down 19% to $10.4 billion this quarter. Regionally, we reduced assets by 22% in the U.S., 19% in Europe, and 10% in Asia. Our gross write-downs were $900 million this quarter, these gross write-downs represent the mark-to-market adjustments on our cash positions. Embedded in these write-downs were gains of $200 million in our fixed rate securities positions. Excluding these gains the write-downs on our remaining positions were closer to $1.1 billion.

In the aggregate we sold approximately $8 billion of commercial assets this quarter. The approximately $8 billion of commercial mortgage and real estate held for sale assets sold this quarter were across the capital structure to over 170 different client accounts and approximately 80% were outright sales without seller financing. During the quarter, we sold a variety of assets and not just the most liquid. We sold $4.2 billion of loans, of which 45% were mezzanine loans and 55% were senior loans. We also sold $2.9 billion of securities and approximately $1 billion of equity. We plan to continue reducing our exposure to commercial mortgage assets and real estate held for sale substantially. However, our intention is to pursue these sales in a measured way.

With respect to other non-mortgage asset backed exposures, these assets were flat at $6.5 billion this quarter. We sold approximately $800 million of assets and had gross write-downs of $400 million during the quarter. These reductions were offset by other purchases as a result of continued trading activity in these assets. This category includes securitized asset backed issuance as well as some whole loans. The largest item included in this category is franchise related whole business financings, for example, IHOP's acquisition of Applebees which has an investment grade rating. In the quarter we saw that risk across the capital structure in this asset. The remainder includes credit CLOs, small business loans, and various asset backed positions related to student loans, credit cards and auto loans, among others. In total, approximately 18% of the book is not investment grade rated or not rated.

Our exposures to acquisition financed facilities are shown on the attachment 7 of the supplemental package, we reduced our total exposure to $18 billion this quarter, from $28.7 billion in the first quarter, a reduction of $10.7 billion or 37%. We reduced our investment grade exposure by 40% to $6.5 billion, driven by $2 billion of sales and syndications and $3.3 billion of commitments rolling off. Since quarter end, approximately $3 billion of the investment grade acquisition financed exposure was subsequently repaid. We reduced our non investment grade exposure by 35% to $11.5 billion, driven by $4.6 billion of sales and syndications, and $1.4 billion of commitments rolling off.

Now I would like to discuss our asset composition and valuations in a bit more detail including a description of our valuation process and controls. I'll also speak to specific marks on certain assets. First, a few moments on our valuation control process. We have an independent product control group of approximately 500 finance professionals dedicated to the production, analysis and reconciliation of daily profit and loss results. In addition, we have a separate valuation group within product control to review and validate that positions are valued appropriately. 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, for example, market partners, IDC and others, review of broker quotes for that or similar assets, review of index levels for certain asset classes, taking into account any basis risk that may exist between cash and synthetic positions, and review of industry research reports.

The control process is also reinforced by internal Sarbanes-Oxley testing whereby our internal audit group conducts tests throughout the year, including the daily P&L controls and month end price verification is performed to established standards. Although certain sectors of the markets are currently distressed, there has been recent sales activity in many asset classes, allowing us to benchmark prices. The strong flows we've seen over the past quarter have given us very good transparency in the marks we have against our remaining positions. As it relates to residential mortgages, as I noted earlier, we sold approximately $11 billion and purchased approximately $6 billion of product this quarter, this activity was across the capital structure and across loan types including Alt-A and subprime, giving us good transparency in our pricing. For residential mortgages we have the components on attachment 4 of the supplemental package.

Our U.S. Alt-A assets totaled $10.2 billion. This includes $2.1 billion of whole loans and $6.5 billion of U.S. Alt-A securities which have been marked consistently with the trades in the market and the prices others have publicly disclosed. Our AAA securities totaled $3.9 billion. The remaining securities, which includes positions across the capital structure, total $2.6 billion. Our subprime positions totaled $2.8 billion. Including $1.1 billion of whole loans, $900 million of AAA securities and $800 million of other securities. While these subprime positions are marked to observable pricing data in the market, our prices are at or below what the ABX indices would imply.

We have $9.3 billion of European residential assets. The majority of which are in the UK market. Our U.K. residential mortgage portfolio is 66% prime or near prime. And 34% non-conforming. These assets include $3.6 billion of whole loans and $5.7 billion of securities. The valuation of our loans and the retained securities reflects available transaction prices on U.K. prime assets and limited observations of non-conforming RMBS prices. Our valuations therefore include adjustments for the asset and credit quality that correspond to a peak to trough decline in house prices of approximately 28%, with prices having fallen 7% to date. The average LTV of our U.K. portfolio is 75%.

The combination of the commercial mortgage and real estate held for sale GAAP asset categories totals $39.8 billion and the components based on lien type which provides a useful way to consider the risk are summarized on attachments five and six of the supplemental package. This portfolio is well diversified by region as well as by number of positions. Of the $39.8 billion, 52% is in the U.S., 27% in Europe and 21% in Asia. Our portfolio includes approximately 2,500 individual positions with an average size of 15.7 million.

Our valuation methodologies and policies use observable trades in the marketplace where we sold approximately $8 billion of assets this quarter, including approximately $2 billion each of senior and mezzanine loans, approximately $2.9 billion of securities, and approximately $1 billion of equity. These broad-based sales, which were done at or very near our marks, give us confidence in our valuations. Barring the availability of observable trades we use third party evaluations and/or conservative yield expectations. We have approximately $5.3 billion of securities, comprised of approximately 370 individual positions with average size of approximately $14 million. 77% of these securities are rated AA or better, with 94% having investment grade ratings.

Our non securities exposures totaled $34.5 billion, and include the following as outlined on attachment 6 of the supplement. $19.5 billion of senior loans made up of 875 individual positions, with an average size of approximately $22 million. Weighted average loan to value for the senior loans is 76%, with an 18 month average loan age. These loans are predominantly floating rate. $5.9 billion of mezzanine loans made up of approximately 300 individual positions with an average size of approximately $20 million. The weighted average loan to value on these mezzanine loans is 78%, with an average loan age of just over a year. These loans are also predominantly floating rate. $1.9 billion of non-performing loans, made up of approximately 330 individual positions with an average size of $5.8 million. These MPLs are mainly in Asia and are purchased as distressed loans at very steep discounts. $7.2 billion of equity, made up of approximately 670 individual positions, with an average size of $10.7 million.

A few points to bring up on valuing these equity positions. These equity positions are predominantly recorded in the real estate held for sale GAAP asset line on the balance sheet and are recorded at lower of cost or market such that unrealized gains which may result from a building repositioning or releasing do not get recognized but any deterioration does. The 670 positions are evaluated individually. The Asia market has not been significantly impacted by the recent credit cycle. For example, we have seen a strong resale market in Singapore and so our equity positions in Asia are generally marked higher than in the U.S.

We have two large positions that I would like to discuss, specifically, SunCal and Archstone. First SunCal. SunCal is one of the largest privately held developers of master planned communities in the Western United States. Lehman's exposure with SunCal is primarily in Southern California and consists of 23 separate residential land development projects and one luxury high rise residential development. These positions, approximately 90% of which were originated as senior debt, have an aggregate carrying value of $1.6 billion are marked in the mid-70s. Excluding the high rise and water front properties, we carry the properties at an average basis of 29,500 per residential lot including the 20,000 per lot for the Inland Empire we noted last week. The portfolio is marked to where an investor could achieve a 15% unlevered return over in excess of a five year hold period. Our 29,500 average basis per lot valuation compares very conservatively to other recent transactions in Southern California.

I'll spend a few moments now on our Archstone equity position. Archstone is a company which owns a 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 in excess of 5%, in addition to last year's growth that was also in excess of 5%. Archstone also has an extensive development platform and land inventory which do not generate current cash flow but have substantial value and are often overlooked in evaluating its valuation. For example, the development platform will deliver projects with over 5,000 units that will begin to contribute to revenue in fiscal 2008. Also, in reviewing a sum of the parts valuation, the company's completed asset portfolio was approximately $328,000 per unit which is at a significant discount to replacement cost of 390,000 per unit estimated by the company last year. Because the company is actively developing units, it has great visibility on these numbers.

Notwithstanding these demonstrations of value, in recognition of the change in real estate valuation metrics, we have taken a significant markdown on the position. Our equity exposure in Archstone is currently carried at 75 for a value of less than $1.8 billion. After we took a mark on the equity position of $350 million this quarter. We have arrived at an Archstone enterprise value primarily using a discounted cash value analysis which supports a mid-teens IRR, we cross checked that using a number of different methodologies, including some of the parts, replacement cost and recent comparable transactions based on both cap rates and price per unit. The most important including asset sales from the Archstone portfolio. For example, to date the company has sold approximately $2 billion of assets, and is under contract or in active negotiation on in excess of another $2 billion. This $4 billion in transactions are at capitalization rates in the mid-4% range. Many of these assets were identified by for sale by the company as non-core or non-strategic assets and in certain cases do not represent the highest quality properties in their portfolio.

It should be noted that our valuation reflect the company's business plans of only selling enough assets to reduce debt to a targeted level and to continue to increase value through its development, asset management, and revenue enhancement programs which have and continue to be very successful. In that context, we have assumed that capitalization rates will be more than 100 basis points higher when the properties are sold than when the transaction was entered into. Based on this analysis, we are very comfortable with our current Archstone mark.

With respect to level three assets, we are still completing our review. Our current expectation is that level three assets will decline from last quarter's level of $40.2 billion. During the quarter, we sold approximately $3.5 billion of level three assets and also had additional write-downs of approximately $2 billion that would have brought us down to approximately $35 billion in combination. However, this reduction will be offset by net transfers in and other activity of approximately $3.5 billion. Therefore, we expect to end the quarter at approximately $38 billion of level three assets. Level three, by definition, includes those assets with low price transparency. While there is more analysis used in establishing the value of these assets, this certainly means -- this certainly by no means implies that these assets have little or no true value. For example, private equity investments are included in level three. So we have brought down level three assets as part of our deleveraging and risk reduction initiative this quarter. We also feel confident in the valuation and underlying value of these assets.

With regard to risk management and capital, our value at risk declined this quarter as we reduced our balance sheet and exposures. This was somewhat offset by an increase in market volatilities. Our period end value at risk at May 31, was $75 million on an unweighted basis. The decline of 16% compared to an unweighted bar of $89 million at February 29. Our value at risk on a weighted basis at May 31, was $104 million compared to a weighted bar of $106 million at February 29.

Regarding another risk item of particular interest, our exposure to monolines remains minimal. To quantify this risk, if all monolines were to default entirely with zero recovery our losses on related positions would be $265 million. 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 $154.5 billion, from $153 billion at the end of the first quarter. We estimate that our Tier 1 capital ratio under the BASL2 like CFC regulatory framework will be over 10% at May 31, and our total capital ratio, over 15%. Both amounts are before our most recent capital raise and our total capital ratio at 15% is well in excess of the 10% minimum regulatory threshold. These estimates are still preliminary and the final numbers will be included in our 10-Q. Both of these ratios will increase with our new capital raise. The total capital ratio is estimated to be not less than 19% and Tier 1 capital will not be less than 12.5%.

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 stockholders' equity is approximately $32 billion, comparable with others in our industry and our pro forma book value per share is $32.95.

Next, let me review our liquidity position which has never been stronger. First, we have significantly increased our cash capital surplus to $15 billion from $7 billion at the end of the first quarter. And our liquidity pool to $45 billion from $34 billion. We completed our funding plan for 2008. We've issued all the long-term debt necessary to refinance current portions this year and do not expect to return to the market with the exception of possible opportunistic prefundings 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. This represents around 19% of our inventory to date, up from around 14% at the end of the first quarter. Our holding company liquidity position which does not include liquidity at our regulated broker dealers and banks nor the $4.5 billion in long-term committed unsecured bank facilities is available to mitigate the liquidity impact of a severe stress event.

In addition to covering all maturing unsecured debt over the next 12 months, the liquidity pool is available to fund potential outflows from loan commitments being drawn, additional derivative collateralization, losses of secured funding and other contingent events. Our liquidity pool is primarily invested in cash instruments, governments and agency securities and overnight repurchase agreements collateralized by governments 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 have excess liquidity of $17 billion and have total unencumbered collateral of $87 billion. We have tested the Fed's new primarily dealer credit facility on occasion with no outstanding balance at quarter end. The last time we accessed the facility was April 16, on an overnight basis. We continue to have no reliance on prime broker customer free credit.

With respect to our secured funding position, total repo is approximately $188 billion, of which matchbook and customer funding is between one-third and a half with the remainder firm inventory. Of this amount, approximately $83 billion is treasuries and agencies. The remaining $105 billion is tri party repo of which approximately $40 billion consists of Central Bank eligible collateral. Of the remaining $65 billion of repo, $25 billion is in investment grade fixed income securities and major index equities, for which there exists a very active, reliable and liquid repo market and a further $8 billion of assets are funded within our own banks. The remaining $32 billion of collateral is funded largely with term facilities. The average tenor of our non Central Bank eligible tri-party repo is now over 40 days. Any loss of repo capacity may be absorbed within our pools of liquidity available to the broker/dealers which represent more than 150% of the remaining repo. Additionally, we have overfunded the tri-party repo book by approximately $27 billion. That is, we have repoed our collateral in excess of firm and client positions, filling this by substituting treasuries and agencies in the U.S. and borrowing in collateral in Europe. This gives us the ability to absorb changes in repo capacity in times of stress by reducing total collateral borrowed in or reallocating the higher quality, easy to fund collateral, outside these facilities as necessary.

In conclusion I reviewed with you the strength we continue to see in our client franchise and our strong capital and liquidity position. In addition, our deleveraging initiative this quarter meaningfully reduced our asset exposures to residential and commercial mortgages, real estate held for sale and acquisition finance facilities and also gave us great transparency in valuing our remaining positions. With that, I'd like to turn the call over to Bart.

Bart McDade - *Lehman Brothers Holdings Inc. - President, COO*

Thank you, Ian, good morning. You heard Dick affirm our continued conviction in the attributes of the Investment Banking model. While we acknowledge our second quarter earnings results as unacceptable, as outlined by Ian, we did make substantial improvements in our liquidity profile, capital base, our balance sheet, and our cost base, with the resizing of our human capital. We now enter the second half of 2008 with tangible capital of more than $33 billion, a figure which is only slightly less than that of two of our direct peer competitors. We have made investments over several years now, adding to our product, and geographical diversification.

Our balance sheet improvements give us the additional resources and additional capacity to drive our client model. Importantly, we are being responsive to the strong messages from the marketplace, making the necessary adjustments to our platforms. Our definition of operational excellence remains intact. First, we're delivering on our client-driven business plans. Second, we are staying the course on our chosen geography and product focus. And finally, prioritization and disciplined choices to ensure that we have proper returns on our chosen investment decisions. We are focused on intensifying our operational excellence.

While we do recognize certain market revenue potential opportunities remain diminished, we are still constructive on our core businesses earnings power. We have received questions with respect to our revenue potential going forward, given our successful deleveraging. Our balance sheet is not a gating factor. We are committed to disciplined and rigorous attention to the return characteristics of our capital. Even in this operating environment we believe that the team can generate mid-teens ROEs. We have the team in place, we have the right business model, the will, and the focus to execute. We appreciate your time today. Operator, we're now happy to open the line for questions. Thank you.

QUESTIONS AND ANSWERS

Operator

Thank you. (OPERATOR INSTRUCTIONS) Please stand by for our first question. Our first question comes from Meredith Whitney. Your line is open.

Meredith Whitney - *CIBC World Markets - Analyst*

Good morning. I wanted to thank you for your extra detail this morning. I have a very basic question surrounding your potential ROEs. If I just used the revenue numbers that you guys have provided, which is 4 billion, $4.2 billion or so, and then the run rate, assuming or not assuming the potential $250 million cost save I get to a pretax number of around, let's call it give or take 500 million, $700 million an after tax per share number of between $0.40 and $0.45 per quarter. So that would be more suggestive of a mid single digit ROE than a mid-teens ROE and I just want to know the steps that you're going to take on the revenue side or on the cost side to ensure a mid-teens ROE and what timetable we're looking at for that? Thank you.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I think I had my microphone on to start off with. So that's an improvement. Happy to take you through that. I think you're right, if the run rate stayed at 4.2, that wouldn't be consistent with a 15% ROE. In order to get to a 15% ROE, given our cost structure, we probably need to generate between 4.9 billion and $5 billion on a run rate basis. As we think about what that's consistent with, though, we have $33 billion of leverageable capital. If we maintain our leverage ratio in the low double digits, so call it, 12 to 15, we would have net assets of probably 400 billion to $410 billion.

If you are looking at revenues to assets, you would need between 4.7 and 4.9 in order to get you to the 4.9 billion to $5 billion of quarterly revenues and to put that in perspective, 4.9 revenue to assets is what we generated in 1999, which was the year after the disruptions from Russia and LTCM. And the longer term 14-year revenue to assets that we've operated with is about 5.3. So given the extra balance sheet that we have and historical levels of revenue to assets, you can see how you could get to 4.9 billion to $5 billion of quarterly revenues and then when you play that through the comp and NPE a little bit below $1 billion and a 30% tax rate, that translates after the preferred payouts to a number that generates 15% ROE on our new common equity.

And in terms of how we think that you could get to between 4.9 billion and $5 billion of revenue per quarter and we're not suggesting that we can get there this particular quarter, we're really just giving you a sense of how one could get there over a period, you have a sense of how our different segments have performed and I shared with you the growth that we've seen in Investment Banking, in Investment Management and how the client franchise has continued to strengthen and a way in which one could get there would be to have Investment Banking at between 800 and 850, Investment Management somewhere between 900,000 and 1 million. Equity at something like 1.3 billion and then that would require fixed income to generate about 1.8 billion. So the 1.3 billion for equities, they've been running well above that in 2007, and actually I think the lowest quarter in 2007 was about 1.3 billion. So you're absolutely right. At the $4.2 billion of revenue run rate, that's not consistent with a 15% ROE. But as we deploy the extra equity, as we see our Capital Market segments getting closer to their historical levels, you could see how we could get to that.

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Meredith Whitney - *CIBC World Markets - Analyst*

Okay. So just as a follow-up, if a lot of the revenues are dependent upon a turnaround in (inaudible), could you provide a timetable of when you see that for your own businesses, you had commented on what part of your revenue stream was generated from structured products but are we looking at any type of turnaround in fixed for Lehman next quarter or the next quarter? Is it an '09, '010 projection? Just a closer timetable would be appreciated. Thank you.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

Obviously, it's impossible to predict future markets and I think that we recognize that the markets continue to be challenging. We're very confident that we can get there but I unfortunately don't -- can't provide you with a specific time of when we think we would get there.

Meredith Whitney - *CIBC World Markets - Analyst*

Okay. Thank you.

Operator

Our next question comes from Glenn Schorr. Mr. Shore, please announce your company name.

Glenn Schorr - *UBS - Analyst*

UBS. Thanks. It seems like we're at the point now where we're okay, capital and liquidity ratios are fine but you still have some large illiquid positions. I want to make sure I heard you correctly. You're saying you're still interested in bringing down the overall size of the residential and commercial books? I just have a follow-up on that, just want to make sure I heard that part correct?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

Yes, we want to diversify our balance sheet. We are committed to bring down our commercial position. As I said, we intend to bring it down substantially but we want to bring it down in a measured way. So the combination of those two items, we intend to continue to bring down.

Glenn Schorr - *UBS - Analyst*

Okay. And then in terms of the--?

Dick Fuld - *Lehman Brothers Holdings Inc. - Chairman, CEO*

I would only add to that, this is Dick. I would only add to that, we have finished in principal with the deleveraging, but that does not mean that we are finished with changing the mix of the assets.

Glenn Schorr - *UBS - Analyst*

I'm with you, Dick. I appreciate that.

Dick Fuld - *Lehman Brothers Holdings Inc. - Chairman, CEO*

Okay.

Glenn Schorr - *UBS - Analyst*

In terms of the actual sales that took place during the quarter in both the residential and commercial books, could you make any comment in terms of vintages sold versus your last disclosure at the conference in May?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I mean, I think -- as you can see by the numbers, the sales were across sort of all asset classes, across all the types. I don't have the details to hand of what the specifics were with regard to vintage but I don't believe there was any concentration with regard to that and just given the size of the sale, that that wouldn't be consistent with just the sizing. So we -- I don't have specific details about which vintage but I can assure you that it was extremely broad-based across all assets and across all vintages.

Glenn Schorr - *UBS - Analyst*

That's good enough. The rating agencies did their thing last month or a couple weeks ago and I think from your last Q it said that one more notch downgrade from here would require $5 billion plus of additional collateral. They didn't remove the negative outlook. I'm assuming that's just an earnings power thing on their part but can you just talk about how important this is to Lehman, if everything's done that you need to do to avoid that, given your comments on liquidity and capital I would think so, but just curious to get your thoughts.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

Yes, I think that -- from the debt holders' perspective, the $6 billion of capital raise has improved their position very substantially. You're seeing that coming through in the CDS levels. With regard to the rating agencies, I believe that their focus is on the earnings power going forward. They are very comfortable with the capital and I took you through what the capital ratios were, which I think we'll see when all the Qs come out but our expectation is that pre the capital raise, we were going to be among the strongest and post the capital raise we certainly are confident that will be the case. So we don't believe there will be any issues around capital. You've got a sense of just how strong our liquidity position is and I think from a debt holders perspective and the rating agency's view of that, their real focus is on the power of the franchise to generate high ROEs going forward.

Glenn Schorr - *UBS - Analyst*

Last one for Dick. We've talked without this in the past, but given everything that the industry's gone through, do you expect anything in terms of material changes from the regulatory standpoint from what we might see from disclosure and pricing, the leverage and capital that the industry's allowed to run at? Just something at the very highest level would be interesting.

Dick Fuld - *Lehman Brothers Holdings Inc. - Chairman, CEO*

I think it's actually too early to comment on that, but I would say, obviously, with the Fed opening the window to the investment banks, I think there's been a lot of conversation about that, whether it's from the Fed or whether it's from treasury, and of course I have a different perspective, obviously, having a seat on the New York Federal Reserve Board. By definition, if they're going to give the investment banks access to the window, I for one do believe they have the right for oversight. What that means, though, particularly as far as capital levels or asset requirements, way too early to tell. I would love to give you an answer on that. But you asked for a high level view. That's probably higher than you wanted.

Glenn Schorr - *UBS - Analyst*

That's all right, Dick, I appreciate. Thanks very much.

Operator

Next question comes from Guy Moszkowski, please state your company.

Guy Moszkowski - *Merrill Lynch - Analyst*

I'm with Merrill Lynch. Good morning. Just a follow-up on the question about the asset sales and whether there were vintage concentrations or anything like that. How about with respect to timing. Were the sales pretty much ratably spread over the quarter or were they more skewed toward either the early or the latter part of the quarter?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

They were spread over the whole quarter. I mean, it was a focus of the entire firm to delever through the course of the quarter. That was obviously a focus which shifted attention to some extent and I think that impacted the quarter in some ways, but it was even across the whole quarter so there was no concentration in terms of the timing and it was -- that was true across all of the elements. So that would be true within resis, within commercial.

Guy Moszkowski - *Merrill Lynch - Analyst*

Okay. You anticipated the next part of the question. So thanks for that. Why does the mark-to-market seem, looking at the regional breakdown of revenues, to be so disproportionately concentrated in Europe and the Middle East? Just given the size of the negative net revenue in that region versus, say, the U.S.?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I think actually the impact in Europe I think in part is as a result of some of the trading that we talked about, as one of the unusual factors, and I think that's probably more of a determinant of the European number than the fact that the write-downs were concentrated there. I don't believe that the write-downs were concentrated in Europe.

Guy Moszkowski - *Merrill Lynch - Analyst*

And just to pursue the European piece for a minute, given that the whole loan sales in Europe were -- the whole loan balance in Europe came down by about $1.4 billion the securities balance rose by 1.2, does that reflect some restructuring of whole loans into securitized assets, to facilitate later sale? Or was it actual portfolio turn?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

Actually, you picked up on a really good point. It was a transfer from whole loans to securities, but it was to improve the liquidity characteristics and that was really what drove that. As part of our efforts, post Bear, we talked about our efforts to convert unencumbered collateral which was 100% cash capital into securities which were available for financing. One of the things we did do in Europe was that switch. So it didn't shift risk but it doesn't changed the funding characteristics of the position.

Guy Moszkowski - *Merrill Lynch - Analyst*

Right. Fair enough. Thank you for that. Can you confirm that -- I know you talked in some detail about Archstone and SunCal and you gave us some good visibility into where those are being carried. Can you just confirm to us that those are actually carried as corporate equity positions, is that right, rather than being included within the commercial mortgage portfolios?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

Archstone is held as corporate equity. But the SunCal is held in real estate held for sale.

Guy Moszkowski - *Merrill Lynch - Analyst*

Okay. And then finally, last week Erin talked about the Firm still expecting to leverage the new capital essentially that the deleveraging is over. I think I heard Dick say a few minutes ago that as far as he was concerned, the deleveraging was pretty much complete. So again, should we expect that within the next quarter or two, we're going to start to see the new capital that's been raised actually get leveraged at something like the gross and net leverage ratios that you're currently carrying?

Bart McDade - *Lehman Brothers Holdings Inc. - President, COO*

Guy, it's Bart. We're certainly advertising that we're going to be prudent about how we deploy that capital. We do see opportunities in markets like this. The ultimate determinant will be the markets and the liquidity characteristics of those markets. But certainly, we are looking to deploy in an incremental basis as we see opportunities unfold.

Guy Moszkowski - *Merrill Lynch - Analyst*

Okay. That's all real helpful. Thank you very much.

Bart McDade - *Lehman Brothers Holdings Inc. - President, COO*

Thanks, Guy.

Operator

Our next question comes from Prashant Bhatia. Please state your company.

Prashant Bhatia - *Citi - Analyst*

Citi. Hi. Just on the -- on attachment 2, the $54 billion of residential and commercial mortgage exposure. Can you just give us maybe your view, rough numbers, on what you think the intrinsic value of that $54 billion is?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I mean, it's all on mark-to-market basis and we feel very good about the valuations. We've had a lot of transparency in the residential space, in the commercial space, as a result of all the sales. So we're very comfortable with our mark-to-market.

Prashant Bhatia - *Citi - Analyst*

Okay. I guess what I'm trying to get at, at the point where you took down quite a bit of exposure there, but in not taking down more, was it a decision that there wasn't enough liquidity in the marketplace or was the decision more we think these assets are worth a whole lot more than the market will give us right now so we'll wait for a different point in time. That's what I'm trying to get at.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

Thanks for that clarification. I think what we would say is that around the residentials, broadly we're comfortable with a level that we have now got to. We plan to obviously change the composition of it as we trade in and out but we're comfortable with that level and I think that when you benchmark our residential exposure relative to our equity, you'll find that that level is consistent what the industry averages. With regard to commercial, as I indicated, we still plan to reduce that over the period, but we want to do that in a measured way so that we don't affect value and so the reason that we didn't sell more commercials over this period is because that would, we think, have affected value. But we do intend to bring that down over time.

Prashant Bhatia - *Citi - Analyst*

Okay. That's helpful. Also, you mentioned picking up I think about $6 billion of residential mortgage assets during the quarter. Could you, one, just maybe give a breakdown of securities versus whole loans there? And two, give us a feel for how much was purchased in the last two quarters relative to that six?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I'm going to have to punt on elements of that. I think that there's an enormous amount of flow through that business and the six I think is just the normal flow. I would imagine the majority of that is securities, rather than loans, but it's really just a huge amount of flow running through that business as we've refocused it from being an origination platform to being a trading platform and consistent with our focus on clients and being a massive facilitator of flow through the marketplace, that's really what we saw. So it wasn't acquiring positions that we thought were distressed. It was really just part of the normal flow of an extremely robust trading business now.

Prashant Bhatia - *Citi - Analyst*

Okay. So would it be fair to assume that you were picking up anywhere close to that level over the last couple of quarters? Or not really?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I suspect that that business is improving as there is a great deal more transparency around pricing. In fact, I'm sure that's true. So I think that the flows that we saw in residentials were substantially higher this quarter than we had seen in the first quarter, as the market got comfortable with pricing and transparency and as a result there was a lot more flow.

Prashant Bhatia - *Citi - Analyst*

Okay. And then can you give us the non-performing loan balances broken down by residential, commercial and real estate investment related?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I think we're going to have to get back to you with that. We're very happy to. I just don't have it to hand.

Prashant Bhatia - *Citi - Analyst*

Thank you so much.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

You're very welcome. Thank you.

Operator

Our next question comes from Mike Mayo. Please state your company.

Mike Mayo - *Deutsche Bank - Analyst*

Deutsche Bank. I have some follow-ups with respect to attachments four through six. Some of these are detailed but I think very important. First, of the $10 billion, last quarter $15 billion of the U.S. Alt-A and prime in the residential mortgage category, how much of that is prime?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I think the majority of that is Alt-A, Mike.

Mike Mayo - *Deutsche Bank - Analyst*

Okay. And of the AAA rated securities, how much is super senior versus mez? That's the category that went from 6 billion to 4 billion.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

Have to get back to you on what that breakout is.

Mike Mayo - *Deutsche Bank - Analyst*

Can you give any rough sense there? Because I think where these securities are trading in the market, it makes a difference.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

No. What I can share with you is that, those AAAs are -- they're marked in sort of the mid-70s, if that helps you.

Mike Mayo - *Deutsche Bank - Analyst*

Okay. And the AAA rated subprime securities, what vintage are those? Are those 2007 or before 2007?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I think they are predominantly 2007, because our origination machine -- our origination model was essentially to originate and then sell out and it's really the 2007 vintage that we ended up holding on balance sheet.

Mike Mayo - *Deutsche Bank - Analyst*

And then Europe residential mortgage pretty good sized numbers there. How much of that is prime versus subprime?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

Well, I think in my remarks we talked about how much was prime, near prime and non-conforming.

Mike Mayo - *Deutsche Bank - Analyst*

Okay.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

It's two-thirds prime and near prime and about one-third non-conforming.

Mike Mayo - *Deutsche Bank - Analyst*

And commercial mortgage, of the $5 billion of securities, how much of that it floating versus fixed?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I think that -- we'll have to get back to you with that, Mike.

Mike Mayo - *Deutsche Bank - Analyst*

And the mezzanine loans under commercial mortgages, there's $6 billion there. How much of that is junior versus senior mez?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

Again, I'm going to need to get back to you on these things.

Mike Mayo - *Deutsche Bank - Analyst*

I guess the general question, have you taken sufficient write-downs, so Dick Fuld, what did it mean when it said you were okay with the valuations at the end of the second quarter and are you okay with the valuations today and can you elaborate on that?

Dick Fuld - *Lehman Brothers Holdings Inc. - Chairman, CEO*

What I talked about, clearly, was the process that we go through. I talked about the huge number of securities and assets that were sold. They gave us price discovery. We also looked at what other people sold and got price discovery from that. And obviously both the cash and the derivative market gave us huge indications. When I say I'm comfortable, understand, I am the one that signs the quarterly document.

Mike Mayo - *Deutsche Bank - Analyst*

Okay. I mean, the reason I ask is there are cases of other top management officials at other companies saying they were fine, and then the next quarter we had big write-downs again. So what's the likelihood of something like that happening?

Dick Fuld - *Lehman Brothers Holdings Inc. - Chairman, CEO*

I certainly can't speak for other companies and I think maybe in some of those cases you had changing markets from one quarter to the next. But my intention at the close of each quarter is to make sure that we are marked appropriately so that when we start off the next quarter, we have a clean slate. That is our mentality.

Mike Mayo - *Deutsche Bank - Analyst*

And just one last follow-up. So are you okay with the valuations a couple weeks into the quarter that they're somewhat consistent with what you had at the end of the quarter?

Dick Fuld - *Lehman Brothers Holdings Inc. - Chairman, CEO*

Am I allowed to answer that. Before I get the answer, I'll just say yes, I am.

Mike Mayo - *Deutsche Bank - Analyst*

Okay. It would be helpful to have some carrying values for all these charts. It's good detail but without knowing the carrying values we're going to have to make a lot of assumptions when we estimate write-downs where they might -- should be.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I think, Mike, we recognize that we've taken the step on the path around providing additional detail and we don't think we've reached the end of that. And it is something that we're going to look to find ways in which we can make these things more apparent to investors. I would say, even though we will get back to you with the exact composition of each of these different items, whatever that turns out to be, we have seen a huge amount of flow through all of those different categories and that's what's provided the information that we needed in order to mark them to where the market is currently trading and the fact that there's so much flow going through gives you a sense of the markets are in fact trading and there is great price transparency around those and we are marked to what that set of data is telling us.

Mike Mayo - *Deutsche Bank - Analyst*

Thank you.

Operator

Our next question comes from Bill Tanona. Please announce your company.

Bill Tanona - *Goldman Sachs - Analyst*

Goldman Sachs. Obviously everybody's asked the questions in terms of where things are marked here and that's obviously a big concern in the marketplace. As I look at the level three assets as you kind of described them being around $38 billion for this quarter, how much of that $38 billion is actually going to be mortgage-related? And I guess the follow-on to that will be if you think about where the criticism might lie, it's going to be in kind of the European piece, which I guess from last call it seems that a big portion of the European mortgage moved from level two to level three so if you could provide any type of granularity in terms of where those things are marked presently.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

Well, let me make a few comments with regard to sort of level three. We did have $40 billion of level three in the first quarter and if you look at the composition of that, probably about 9.5 of that was in corporate equity and about 3 was in derivatives. So if you recognize that those are positions which are sort of held because we feel good about them over the long-term, the piece that was available for sale through our deleveraging process was probably around 28 of the 40. And of that 28, we sold 3.5. So that's about 13% of our level three assets that were part of the sale program were actually sold through the quarter.

With regard to where mortgage and asset backed securities is likely to be, it really is too early in this process for me to give you a sense of that. But it's more likely to be down and I think I'm probably comfortable saying that as a result of what we've seen in the quarter, it will be down. But I can't quantify for you how much it is down. And then with regards to the European portfolio, I did indicate to you in the remarks that implicit in where we've valued the European mortgages is 28% decline in housing prices and what we're seeing is 7%. So we believe that the marks that we have are conservative, given that 28% is a huge amount of -- there's a huge price depreciation relative to what we've seen baked into where we've marked the various securities. There is some research that suggests that housing prices could come down 20% in the U.K. There's some research that suggests maybe it's 30%. But our levels are towards the most conservative end of that.

Bill Tanona - *Goldman Sachs - Analyst*

But as you gave with some of the U.S., I mean, can you give a level as which you think those are marked on average?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

On average, I think the position is marked in the low 80s.

Bill Tanona - *Goldman Sachs - Analyst*

Okay. Great. Thank you. And then I'm sure there's going to be questions as well in terms of the gross assets declining more than they did last week as well as the net. Obviously I know you guys are a big company, there's a lot of moving parts but just thought I would ask in terms of what drove the additional declines there, both in total and adjusted assets?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I think that we were obviously doing work through the course of the week. I think people wanted to make sure that they didn't underdeliver, people were conservative with regard to where they thought certain items that hadn't been completely resolved were going to come out and so I think that really is the reason. Nobody wanted to disappoint the market in a circumstance like this and so just -- we're just a little conservative on the unresolved items.

Bill Tanona - *Goldman Sachs - Analyst*

Understandable. And then in terms of the commentary from Dick earlier with securitization origination and leveraged loan being less than 10% of revenues in kind of 2007, I guess the question I would have is how did the profitability of those businesses compare, not just the revenues?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I think the profitability was broadly in line with what the revenue component was.

Bill Tanona - *Goldman Sachs - Analyst*

Okay.

Dick Fuld - *Lehman Brothers Holdings Inc. - Chairman, CEO*

Also -- this is Dick. Remember, in 2007, we also had write-downs against those assets. So I look at it that I didn't really lose a whole lot of profitability there.

Bill Tanona - *Goldman Sachs - Analyst*

And I guess if you took it a year later or before in terms of '06, what would have been kind of the profitability of those businesses in '06 to exclude those write-downs?

Dick Fuld - *Lehman Brothers Holdings Inc. - Chairman, CEO*

I would say -- well, clearly in '06 we didn't have the write-downs but even by the end of '06, you saw that we began to make adjustments in those mortgage positions and by '07 we were already well on to a different model. I think '06 we were, what, 17 -- 17, what, 17.7, 17.6 and I think there it was probably -- it could easily have been 10% of both net income and revenues. But then obviously with '07, a record year, we had none of that. I shouldn't say none of that. We had a de minimus piece of that.

Bill Tanona - *Goldman Sachs - Analyst*

Okay. And then just lastly in terms of the revenue breakdown by region, can you just help me understand exactly why the revenues had changed so dramatically in those specific regions? I guess following on the other question, I would have thought with the level of write-downs it would have been far more damaging to the U.S. profitability in revenues than it would have been to some of those other regions.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

Yes, I think that when you look over the six months you see a very comparable revenue breakouts and composition to what you saw in the first quarter. So I think that what we've seen is essentially a very even distribution this quarter, it's followed essentially the same pattern. So we didn't see diversification in the form of higher revenues in Europe and Asia and the big loss in the U.S. The impact of the quarter, which included write-downs but also included principal, included trading, was evenly bad across each of the different regions.

Bill Tanona - *Goldman Sachs - Analyst*

Okay. Thank you.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

Thank you very much.

Operator

Our next question comes from Douglas Sipkin. Please announce your company.

Douglas Sipkin - *Wachovia - Analyst*

Yes, thanks, Douglas Sipkin from Wachovia. Just a couple of questions, a little bit more focused on the revenue side. First off, I know you guys have mentioned several times you had record prime brokerage revenues. Can you first tell us what you attribute that to? And then can you provide us with some comparison with either last quarter or the year-over-year to put it in some context?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I think that what's going on within the prime broker business is that even though there's some modest decline in balances, the business is restructuring. It used to be that the financing was all done essentially at the same price, irrespective of asset class and the term of the financing and what we've seen, particularly in the post Bear period, is that the prime broker pricing has become much, much closer to the repo pricing and as a result there's a real curve there now for financing. It has higher margin because different asset classes have higher haircuts as well as different rates associated with them. So what we're seeing here is a classic version of leverage is more expensive where we have more pricing power with regard to that and as a consequence the business is just more profitable for us even though the balances are somewhat lower.

Douglas Sipkin - *Wachovia - Analyst*

And can you by any chance put that into some sort of sequential or annual context? From a revenue standpoint?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

The revenues are about 5% higher in the second quarter than they were in the first quarter.

Douglas Sipkin - *Wachovia - Analyst*

Okay. Great. That's helpful. Then also, I know -- I appreciate you guys put out or discussed on the call the sort of potential ROE analysis and obviously releveraging some of that capital is part of that. You guys have also talked about an improving ROA at some point as bid ask spreads widen in certain areas. Have you seen that yet or is that something you're anticipating as more and more capacity comes out of some of the trading asset classes and some of your competitors pull away from the business? Is that something that you're seeing right now or is that something you're anticipating?

Dick Fuld - *Lehman Brothers Holdings Inc. - Chairman, CEO*

I think it's something that we would say is a mix of both, Doug. Which is we have started to see it in certain of the asset classes where some of the balance sheet challenges and risk appetite decline from the competition has been most stark so clearly U.S. residential mortgages would be a great example of that. But we're seeing it in a number of the fixed income over-the-counter asset classes and we would expect with examples of business units from some of our competitors also starting to be shut or skinnied down, we would expect the trend to continue and broaden in terms of both geography and product.

Douglas Sipkin - *Wachovia - Analyst*

Great. Thank you.

Operator

Our next question comes from Jeff Harte. Please announce your company.

Jeff Harte - *Sandler O'Neill - Analyst*

Hi, this is Jeff Harte from Sandler O'Neill. Good morning. Can you guys talk a little bit about how you may be approaching the risk management and kind of hedging process strategically in light of what's going on? You mentioned in the Q&A or in the prepared remarks, you continue to be hedged. Are you thinking any differently about gross exposures versus net exposures with what the hedges did to you this last quarter?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I think we're thinking about it in the same way. I think the hedges have performed very well for us over a long period of time and have mitigated the effect of the write-downs very substantially. We think it's appropriate for us to not be just along these assets but to continue to hedge. We talked about last week how the basis shift between cash and derivatives was a big factor in why the hedges didn't perform. But we do believe that being hedged is the right way to approach this.

Jeff Harte - *Sandler O'Neill - Analyst*

But is -- some of the 70% hedge efficiencies you were seeing in previous quarters, I mean, is that kind of your thought process going forward or do you look at that as kind of an aberration of being overly effective.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

We would like to think of the 70% as the level of effectiveness we would want to see and we expect to see of our hedges and it was the last quarter that was the average of one.

Jeff Harte - *Sandler O'Neill - Analyst*

And you mentioned when talking about commercial mortgage sales, I believe you said that 80% of the sales were without self funding. Of the 20% that were self funded, are we talking 100% full sale finance and how does that compare to historical ARMs? Is 20% self financed high, low, normal?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I think that we believe that that's actually very low and that we've been very disciplined about ensuring that the sales are outright sales that don't involve financing. So I think you'll find that the 20% is low. We do have substantial margin on the positions that we are financing so that we have genuine risk transfer and I think those haircuts are in the 35% plus range.

Dick Fuld - *Lehman Brothers Holdings Inc. - Chairman, CEO*

I think as well, Jeff, the recourse terms are very different than what you might have seen in terms of market practice on the high yield side. So better features and protection for Lehman over the commercials versus high yields.

Jeff Harte - *Sandler O'Neill - Analyst*

Okay. Thank you.

Operator

Our next question comes from Jim Mitchell. Please announce your company.

Jim Mitchell - *Buckingham Research - Analyst*

Yes, hi, Buckingham Research. Could we jump back to the revenue run rate for a second and more specifically in equities. If you kind of normalize for the private equity decline this quarter, it seems like the run rate this quarter was down a little bit. Is that just a function of pretty bad markets on the principal side. How do we think about that going forward? Then particularly in the context of yours and other commentary about May generally being a pretty strong month from a revenue run rate perspective and how we think about equities within that context?

Bart McDade - *Lehman Brothers Holdings Inc. - President, COO*

Jeff, it's Bart. The equity business had challenging markets, particularly outside of the Americas in the second quarter. The dynamic in our business' performance was affected almost exclusively by March. I think Ian explained in good detail that a lot of the segment that you see is a result of activities that the Firm takes in equity risk, which is not part of the actual equity franchise itself. So that explains a substantive piece of it. The other piece that we would argue as being market affected are some of the structured volatility products, which have been more challenged with real underlying equity markets being dislocated, particularly outside the U.S.

Jim Mitchell - *Buckingham Research - Analyst*

So do we see that improve in May along with fixed income?

Bart McDade - *Lehman Brothers Holdings Inc. - President, COO*

We did. It was a tale of -- it was really a tale of March and then the other two months for equity franchise, much more normalized run rates.

Jim Mitchell - *Buckingham Research - Analyst*

Okay and just a quick update in the first two weeks of June, obviously very early in the quarter. Any kind of thoughts there?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

We've had a good start. It's obviously very early days in the quarter, so couple of weeks don't tell you how the whole quarter is going to turn out but the first couple of weeks have been strong.

Jim Mitchell - *Buckingham Research - Analyst*

Okay. Great. Thank you very much.

Operator

Our next question comes from David Trone. Please announce your company.

David Trone - *Fox-Pitt Kelton - Analyst*

Good morning. It's Fox-Pitt Kelton. My questions have been answered but I thought I would throw a big picture one in. Following-up on the regulation question, let's say hypothetically you ended up, along with your peers regulated to the same extent that the banks are. Wouldn't that at that point -- and again, just hypothetically, wouldn't at that point -- wouldn't that put the kabash on the justification for independence? Wouldn't you at that point have -- be motivated to get together with a bank?

Dick Fuld - *Lehman Brothers Holdings Inc. - Chairman, CEO*

This is Dick. To begin with, I have said many times that I very much believe that this franchise's strength and power, we can go it alone. I believe in the model. I believe in the value of what we have created in the past for shareholders can be created again. But I have also said that we are a public company and if there is another model or more importantly someone comes forward that we believe can create more shareholder value than our model can create, I clearly have the obligation to take that to the Board and if it's reasonable, to be considered. I have always said that. If the model changes, so that -- for example, I guess your question was banks are the only way to go, then that is a model that has to be considered. But today, the power of this franchise, we can very much go it alone and be very strong.

David Trone - *Fox-Pitt Kelton - Analyst*

Okay. Great. Thank you.

Operator

Our final question comes from Michael Hecht. Please announce your company.

Michael Hecht - *Banc of America - Analyst*

Banc of America. Hi, guys. Can you hear me.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

Yes, we can. How are you, Michael.

Michael Hecht - *Banc of America - Analyst*

Pretty good, thanks. Hard to believe there's any questions left.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

That's the way we feel.

Michael Hecht - *Banc of America - Analyst*

I had one more follow-up on the quality of the marks this quarter. I think you answered in one of the questions before to Mike's question, on where the cumulative marks were on the AAA piece of the Alt-A book. I'm just trying to get a sense overall, the overall Alt-A book what are the cumulative marks? Is it marked now to $0.70 on the $1? $0.80 on the $1? Do you have that.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

It's in the 70s.

Michael Hecht - *Banc of America - Analyst*

In the 70s. That's close enough. Then it doesn't sound like it, but from a client facing revenues you guys went through, we just wanted to be clear. Are you guys seeing any impact, some of the rumors circulating in the marketplace, driving a reduction in client activity or counter parties pulling away from Lehman?

Dick Fuld - *Lehman Brothers Holdings Inc. - Chairman, CEO*

We've seen nothing significant across prime broker balances, derivatives, secured lending markets, short end unsecured markets, we've seen nothing significant.

Michael Hecht - *Banc of America - Analyst*

Okay. That's helpful. Then you guys know you've brought leverage down here pretty substantially. But can you help us understand how you determine what the right leverage metric is and as part of that how much of the deleveraging and capital rate that's going on is at the request of regulators versus trying to allay investor concerns. Does leverage, defined as assets, or net assets over equity really the right metric since you guys and the industry report your derivatives trading book at fair value versus the total notional amount?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I think we decided to do this. It was a decision that the Firm took. We were not pushed to do this by anybody. I think we feel the appropriate leverage for us to operate is in the low single digits at the moment. We're in the process of moving out of positions that we think are too concentrated and diversifying our balance sheet. So I think that we feel that that's all appropriate and the right way for us to go. I think that leverage is only one metric that gets utilized. It is something that -- I'm sorry, the leverage we want to have in low double digits.

The -- leverage is one metric which the market does look at. It's sort of a high level view of how much risk you're taking relative to your equity. Obviously, there are much more precise metrics but those often are different across firms and they're difficult for folks to make real comparisons around but certainly we think that the CSC equity calculations are going to provide another way for the market to get a sense of how much equity do different firms have relative to their risks and while we would argue that those are probably the more relevant metrics because they do go into understanding one of the hedges against positions and to your point reflect derivatives in a different way, those are ones that the comparison across firms is difficult. So I think leverage is always going to be important. People are going to look at it. We're going to operate conservatively. But as you say, there will be other metrics and we're continuing to be conservative on those metrics as well.

Michael Hecht - *Banc of America - Analyst*

Okay. Thanks. Then thanks for the extra color on your repo financing this quarter. Was just wondering if it's possible to get a sense of the incremental or how we should think about the incremental funding costs for maybe terming out some of the facilities you went through?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I think that in aggregate, our funding businesses are actually making quite a lot more money, so essentially it sort of offsets in large metric. I think the thing that will affect our overall costs structure will be the extra long-term debt that we've actually issued over the last period, more than it is the increased price of secured financing, either through the term extension or as a result of the overfunding. And in any event, whatever those costs are, are almost inconsequential in consequence relative to making sure that the Firm is a complete fortress around liquidity.

Michael Hecht - *Banc of America - Analyst*

Okay. No, agreed. Question on the Asset Management business, the money front outflows of $11 billion in Q2 seemed a bit heavy. I know April is a tax payment month but if we go back to Q2 a year ago, I think you guys saw $2 billion of inflows. I think the industry data was still strongly positive for Q2. Any more color on what went on there?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I think the assets under management are flat quarter on quarter. And the fact is that the mix has improved. So I think that's what we would really point you to.

Michael Hecht - *Banc of America - Analyst*

Okay. And then just a couple of quick follow-ups on expenses. Comp expense, I'm still a little confused on how comp expense goes up $500 million quarter-over-quarter when you kind of saw $1 billion reduction in revenues, if we use your normal run rate, and you gave us $4.2 billion this quarter and I think it was maybe $5.3 billion or something last quarter. Did you guys just underaccrue last quarter or how do we think about how much flexibility you have?

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

I think a way to think about that is actually if you look at it relative to the run rate levels and adjust for the severance, it's about a 50, 52% comp ratio. So ex that, I think we're -- that's in and around where one would have expected to see an accrual.

Michael Hecht - *Banc of America - Analyst*

Okay. Fair enough. Thanks a lot.

Ian Lowitt - *Lehman Brothers Holdings Inc. - CFO*

All right. Just in closing, I want to thank you all for participating. I think we've gotten a number of very interesting questions, which actually have helped us explain where we are. All of you have spent a lot of time and effort and I appreciate the fact that you've been with us. That's it for us.

Operator

Thank you for joining today's conference. That does conclude the call at this time. You may disconnect.