PARTICIPANTS

Richard S. Fuld, Jr. – Chairman and CEO
Ian T. Lowitt – CFO and Co-Chief Administrative Officer
Herbert H. McDade, III – President and COO
Edward S. Grieb – Director of Investor Relations

MANAGEMENT DISCUSSION SECTION

Edward S. Grieb, Director of Investor Relations

Financial Measures

- This presentation contains certain non-GAAP financial measures
- Information relating to these financial measures can be found under selective statistical information, reconciliation of average stockholders' equity to average tangible common stockholders' equity 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

Richard S. Fuld, Jr., Chairman and CEO

Q2 Review

- Let me just begin by saying that I am very disappointed with these financial results
- We lost $2.8B and 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 are 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

Leveraging Intellectual Capital

- We leverage our intellectual capital across the platform to provide best solutions to 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

Creating Revenues

- We have created significant revenues in 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 deliver

Asset Valuation

- 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 in the cash, and then certain 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 have asked Ian in his presentation to take you through more detail than we have before

Management Changes

Joe Gregory

- Now let me talk about the management changes that we made last week
- Joe Gregory stepped down from his role as President and COO
- Joe has 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

Bart McDade

- Our new President and COO, Bart McDade, has been my partner and 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 in fixed income, in equities and in banking
  - This firm is known for its operating excellence, and together, Bart and I will restore that reputation

Erin Callan

- 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

- 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 is already well known to many of our debt and equity investors, our analysts and the rating agencies

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- I must tell you I have huge confidence in Ian

Balance Sheet

- Regarding our balance sheet; we reduced our gross assets by $147B over the quarter, which exceeded the targets that we set
    - We also raised 10B of tangible equity since the beginning of Q2
- For pro forma, we now have 33B of tangible equity
- So we are in a position today to support our clients in these challenging markets

Revenues

- Now, let me talk about the make-up of our revenues and talk first about what we have lost
- Residential and commercial mortgage origination and the securitization of those products, as far as I am 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 are doing deals on better terms, those revenue opportunities, I believe, will remain weak for the next 6 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

Reducing Resources

- 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 sat in those businesses
    - Those are some of the reasons that I am 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

Global Capital Market Client Franchise

- We have a leading global capital market client franchise across both equities and fixed income
- Our client revenues are up about 30% y-over-y
- We also have an Investment Banking franchise that's growing fee share, most of that coming from increased market share in M&A, in equity and equity-related and high-grade debt issuance

Investment Management

- Our newest pillar, Investment Management, is winning institutional strategic mandates as 277B 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

Growth Opportunities

- In addition to all that, within our core businesses we have a number of growth opportunities focusing on Asia broadly and the BRIC countries and then globally in our equity flow businesses and the rates and credit flow trading businesses, prime services, and commodities and foreign exchange and private equity
  - This year, we have already hired about 2,700 people and we have redeployed about 1,000 people, many of whom will join those targeted new areas
  - We are also deploying capital to support these growing businesses
  - These are good opportunities
  - The key, the key is to execute

Concluding Comments

- As all of you know, these are still challenging markets
- Our core franchise, 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 have made a number of changes
- It's now my job to make sure that we execute

Ian T. Lowitt, CFO and Co-Chief Administrative Officer

Financial Performance

- Last Monday's pre-announcement 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 have strengthened liquidity through the quarter
  - And finally, Bert will be wrapping up for us

Net Revenues

- So a lot to cover; let me 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 668mm and net loss of 2.8B and a diluted loss per share of $5.14
- The markets were impacted this quarter by a significant dislocation in spread movements between derivative instruments and cash assets

Gross Mark-to-Market Adjustments

- This quarter, we reported gross mark-to-market adjustments of 3.6B, concentrated in our residential and commercial exposures
    - However, these gross mark-to-market adjustments were 23% lower than the 4.7B of gross adjustments recorded in Q1
    - Additionally, this quarter, we incurred a net loss of 100mm on our hedges against these assets for net mark-to-market adjustments of 3.7B
    - These hedges had provided significant benefits in prior periods

Net Adjustments

- So while our gross mark-to-market adjustments were lower than Q1, our net adjustments were more than double Q1 level of 1.8B
- Our principal portfolios also incurred losses of approximately 500mm this quarter including 300mm recorded in the equities' component of Capital Markets including our mark-to-market adjustment on our investment in GLG

Losses Associated with Defensive Positioning

- We had approximately 700mm 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 4.9B
- That means the remainder of our business generated revenues of approximately 4.2B
- We believe the 4.2B 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

Compensation Expense

- With respect to expenses, for the quarter, our total compensation expense was 2.3B, a 418mm 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 140mm that were included in the compensation expense

Head Count

- Our head count declined by 1,900 as we continue to scale our businesses to the respective opportunities

- Our non-personnel expenses totaled 1.1B for the quarter
  - In this area, we have implemented a number of further cost savings initiatives, which we expect will generate approximately 250mm in annualized savings going forward

Segments Performance

Investment Banking

- I now want to discuss the continued strength of our underlying client franchise
- The easiest way to do this is to review our performance by business segment
- In Investment Banking, we posted revenues of 858mm, essentially flat vs. the sequential period and down 25% y-over-y
- The pre-tax operating income for the segment this quarter was 193mm representing a pre-tax margin of 22%

Banking Franchise

- 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 1.2B in Q2 last year
- YTD, 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 150B of equity and hybrid capital in the first five months of 2008, excluding self-issuances
- We lead-managed 37% of this volume, including:
  - 5.2B of new capital for Fannie Mae
  - 7B for Washington Mutual
  - 1.5B for CIT
  - And 1.4B for Sovereign Bank Co

Equity Origination

- In Equity origination, our revenues totaled 330mm, up 54% from last quarter and flat vs. the year-ago period
- Globally, we have grown our equity markets share from 5.8% this year from 3.6% in 2007, and we are now number three YTD in U.S. follow-ons with 12.4% market share, up from 7.8% in 2007
- Fixed Income origination revenues were 288mm, down 11% sequentially and 47% vs. the year-ago period
- YTD, 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, $9B for GlaxoSmithKline and 8.5B for GECC

M&A Advisory

- Our M&A advisory revenues were 240mm, down 27% sequentially and 13% vs. 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

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- We currently rank number four in the U.S. and number one in Asia-ex-Japan in announced M&A
- As of Q2, we have advised on three of the top four completed deals and three of the top ten announced M&A transactions of the year
- We are working on some of the largest assignments in Q2 including:
  - HP's acquisition of EDS
  - Sprint Nextel's joint venture with Clearwire
  - Liberty Mutual's acquisition of Safeco
  - And Finmeccanica's acquisition of U.S. defense company, DRS
- We also closed the Philip Morris International spin-off and the Carlsberg'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

Investment Management Business

- 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 848mm this quarter, down 12% sequentially and 10% higher than Q2 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

Assets Under Management

- Our Assets Under Management were flat this quarter at 277B 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 4B of inflows in higher fee-based alternative assets
- May's inflows were particularly strong vs. March's outflows
- The pre-tax operating income for the segment this quarter was 229mm representing a pre-tax margin of 27%
- We have been growing the revenues and margin in this business as part of our diversification and growth strategy
  - To give you a sense of the rate of growth, from 2004 through 2007, our revenues in AUM grew at compound annual growth rates of 22% and 27% respectively

Private Equity Assets

- Our Private Equity assets have grown over 45% in the past 12 months
- And more broadly, new important mandates with Ford Motor Company and Teachers (sic) [Teacher] 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 bench marks 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 have 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 3B of goodwill we currently have on our books

Capital Markets Segment

- Moving to our Capital Markets segment, we posted revenues of negative 2.4B compared with 1.7B in the sequential period and 3.6B in Q2 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% vs. H1 2007
- In Q2, 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 FYs

Fixed Income Segment

- In the Fixed Income segment of Capital Markets, client revenues for H1 2008 grew 40% over H1 last year, including growth of over 35% in each of our regions
- Our second quarter client revenues were down 2% from Q1 and up 27% vs. last year
- YTD, 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 rate and financing, which are all up significantly vs. 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

Structured Credit, Commodity and Municipal Business

- 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 H1 including growth of approximately 10% or more across each of our regions
  - This quarter, equities client revenues were down approximately 3% vs. 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% YTD
  - 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 Q2
- In summary, the level of client activity across businesses, products and regions is solid and growing, and this is indicative of the underlying value of our franchise

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Leverage

Gross Assets and Net Assets

- Turning now to the leverage, we reduced our gross assets by 147B from 786B to 639B in Q2 and we reduced net assets by 70B from 397B to 327B
- As a result, we reduced our gross leverage from 31.7 times to 24.3 times at May 31st and we reduced net leverage from 15.4 times to 12 times prior to the impact of last week's capital raise
  - 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 24.9B this quarter from 31.8B in Q1, a decline of 6.9B or 22%

Securities Portion of Exposure

- The securities portion of our exposure is now 15B, a reduction of 18% from 18.2B last quarter
- Whole loans are now 8.3B, a 30% reduction from 11.9B last quarter and servicing is at 1.6B
  - Both write-downs for the quarter were 2.4B, 20% lower than Q1

Residential Mortgage Assets

- During the quarter, we sold approximately 11B of residential mortgage assets and purchased approximately 6B for net sales of 5B, 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 Alt-A assets by 30% to 10.2B from 14.6B and we also reduced our subprime assets by 30% to 2.8B from 4B
- We reduced European residential assets to 9.3B this quarter from 9.5B in Q1 and we reduced our gross ABS CDO exposure to 600mm from 900mm 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 a combination of the commercial mortgage and real estate held-for-sale GAAP asset line to 39.8B this quarter from 49B in Q1, a decline of 9.2B or 19%
- We have combined these two categories together given their very similar characteristics
  - The whole loans are now 19.9B, down 20% from 24.9B last quarter

Securities and Other

- Securities and other are 9.5B, a 15% reduction from last quarter's 11.2B, and real estate held-for-sale is down 19% to 10.4B this quarter
- Regionally, we reduced assets by:
  - 22% in the U.S
  - 19% in Europe
  - And 10% in Asia

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Gross Write-Downs

- Our gross write-downs were 900mm this quarter
- These gross write-downs represent the mark-to-market adjustments on our cash positions
- Embedded in these write-downs were gains of 200mm in our fixed rate securities positions
- Excluding these gains, the write-downs on our remaining positions were closer to 1.1B
    - In the aggregate, we sold approximately 8B of commercial assets this quarter
    - The approximately 8B 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 4.2B of loans of which 45% were mezzanine loans and 55% were senior loans
- We also sold 2.9B of securities and approximately 1B 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

Other Non-Mortgage Asset Backed Exposures

- With respect to other non-mortgage asset backed exposures, these assets were flat at 6.5B this quarter
- We sold approximately 800mm of assets and had gross write-downs of 400mm 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 Applebee's which has an investment grade rating
- In the quarter, we sold out risk across the capital structure in this asset and the remainder includes credit CLOs, small business loans and various asset backed positions related to student loans, credit cards and order loans among others
    - In total, approximately 18% of the book is non-investment grade rated or not rated

Exposures to Acquisition Finance Facilities

- Our exposures to acquisition finance facilities are shown on the attachment seven of the supplemental package
- We reduced our total exposure to 18B this quarter from 28.7B in Q1, a reduction of 10.7B or 37%
- We reduced our investment grade exposure by 40% to 6.5B, driven by 2B of sales and syndications and 3.3B of commitments rolling off
    - Since quarter end, approximately 3B of the investment grade acquisition financed exposure was subsequently repaid
- We reduced our non-investment grade exposure by 35% to 11.5B, driven by 4.6B of sales and syndications and 1.4B of commitments rolling off

Asset Composition and Valuations

- 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 will 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
  - Comparisons of 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

Control Process

- 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 have seen over the past quarter have given us very good transparency in the marks we have against our remaining positions

Residential Mortgages

- As it relates to residential mortgages, as I noted earlier, we sold approximately 11B and purchased approximately 6B 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 four of the supplemental package
- Our U.S. Alt-A assets totaled 10.2B
  - This includes 2.1B of whole loans and 6.5B 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 3.9B
- The remaining securities which include positions across the capital structure totaled 2.6B

Subprime Positions

- Our subprime positions totaled 2.8B including 1.1B of whole loans, 900mm of AAA securities and 800mm 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 9.3B of European residential assets, the majority of which are in the UK market
- Our UK residential mortgage portfolio is 66% prime or near prime and 34% nonconforming
  - These assets include 3.6B of whole loans and 5.7B of securities

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Valuation of Loans and Retained Securities

- The valuation of our loans and the retained securities reflects available transaction prices on UK prime assets and limited observations of nonconforming 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 UK portfolio is 75%
- The combination of the commercial mortgage and real estate held-for-sale GAAP asset categories totals 39.8B, 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 39.8B, 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 15.7mm

Valuation Methodologies and Policies

- Our valuation methodologies and policies use observable trades in the marketplace where we sold approximately 8B of assets this quarter including:
    - Approximately 2B each of senior and mezzanine loans
    - Approximately 2.9B of securities
    - And approximately 1B 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 our conservative yield expectations
- We have approximately 5.3B of securities comprised of approximately 370 individual positions with average size of approximately 14mm
    - 77% of these securities are rated AA or better with 94% having investment grade ratings

Non-Securities Exposures

- Our non-securities exposures totaled 34.5B and includes the following as outlined on attachment six of the supplement
- 19.5B of senior loans made up of 875 individual positions with an average size of approximately 22mm
- Weighted average loan-to-value for the senior loans is 76% with an 18 month average loan age
    - These loans are predominantly floating rate
- 5.9B of mezzanine loans made up of approximately 300 individual positions with an average size of approximately 20mm
- 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
- 1.9B of non-performing loans made up of approximately 330 individual positions with an average size of 5.8mm
- These NPLs are mainly in Asia and are purchased as distressed loans at very steep discounts
- 7.2B of equity made up of approximately 670 individual positions with an average size of 10.7mm

Equity Positions

- 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

SunCal and Archstone

SunCal

- 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 1.6B and are marked in the mid-70s
- Excluding the high rise and waterfront 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 5-year hold period
- Our 29,500 average basis per lot valuation compares very conservatively to other recent transactions in Southern California

Archstone Equity Position

- I will 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%

Development Platform and Land Inventory

- 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 FY2008
- 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

Equity Exposure

- Our equity exposure in Archstone is currently carried at 75 for a value of less than 1.8B after we took a mark on the equity position of 350mm this quarter
- We have arrived at an Archstone's 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 sum of the parts, replacement costs 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 2B of assets and is under contract or in active negotiation on in excess of another 2B
  - This 4B in transactions are at average capitalization rates in the mid 4% range
- Many of these assets were identified 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 plan 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 100BPS 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

Level Three Assets

- 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 40.2B
- During the quarter, we sold approximately 3.5B of level three assets and also had additional write-downs of approximately 2B that would have brought us down to approximately 35B in combination
  - However, this reduction will be offset by net transfers in another activity of approximately 3.5B
- Therefore, we expect to end the quarter at approximately 38B of level three assets

Assets with Low Price Transparency

- 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 by no means implies that these assets have little or no true value
  - For example, private equity investments are included in level three
- Though 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

Risk Management and Capital

- With regard to risk management and capital, our value at risk declined this quarter as we reduced our balance sheet in exposures

  - This was somewhat offset by an increase of market volatility
- Our period end value at risk at May 31 was 75mm on an un-weighted basis, a decline of 16% compared to an un-weighted bar of 89mm of February 29
- And our value at risk on a weighted basis at May 31 was 104mm compared to a weighted bar of 106mm at February 29

Exposure to Monolines

- 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 265mm
- We ended the quarter with total stockholders equity of approximately 26B, up 6% from Q1 level
- Our long-term capital rose to 154.5B from 153B at the end of Q1
  - We estimate that our tier 1 capital ratio under the Basel II-like CSE regulatory framework will be over 10% at May 31, and our total capital ratio over 15%
  - Both amounts are before our most recent capital rates 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

Capital Ratio, Book Value per Share and Pro Forma Stockholders Equity

- 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 32B, comparable with others in our industry and our pro forma book value per share is $32.95

Liquidity Position

Cash Capital Surplus

- Next, let me review our liquidity position which has never been stronger
- First, we have significantly increased our cash capital surplus to 15B from 7B at the end of Q1, and our liquidity pool to 45B from 34B
- 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 pre-fundings for 2009

Funding Provided by Banks

- We have also increased the funding provided by our banks and will continue to grow this funding source
- We had 47B of assets funded in our banks as of Q2, up from 44B at both the end of Q1 and year end
  - This represents around 19% of our inventory today, up from around 14% at the end of Q1

Holding Company Liquidity Position

- Our holding company liquidity position, which does not include liquidity at our regulated broker dealers and banks, nor the 4.5B 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

Liquidity Pool

- Our liquidity pool is primarily invested in cash instruments, government and agency securities and overnight re-purchase agreements collateralized by governments and agency security
    - In addition, our holding company and unregulated affiliates have approximately 59B of additional unencumbered collateral
    - Our bank equities and regulated broker dealers also have access liquidity of 17B and have total unencumbered collateral of 87B
- We have tested the Fed's new primary dealer credit facility on occasion with no outstanding balance at quarter end
- The last time we accessed the facility was April 16 on an overnight basis
    - We continue to have no reliance on prime broker customer free credit

Secured Funding Position

- With respect to our secured funding position, total repo is approximately 188B, of which matchbook and customer funding is between one-third and a half, with the remainder of firm inventory
    - Of this amount, approximately 83B is treasuries and agencies
    - The remaining 105B is tripod repo, of which is approximately 40B consists of central bank eligible collateral
- Of the remaining 65B of repo, 25B is an investment grade fixed income securities and major index equities for which there exists a very active, reliable and liquid repo market, and a further 8B of assets are funded within our own banks

Term Facilities

- The remaining 32B of collateral is funded with term facilities
- The average tenor of our tripod 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 over-funded the tripod repo book by approximately 27B
- That is, we have repo'd 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 of these facilities as necessary

Concluding Comments

- In conclusion, I reviewed with you the strength we continue to see in our client franchise and our strong capital and liquid position

- In addition, our deleveraging this initiative this quarter meaningfully reduced our asset exposures to residential mortgages, real estate held for sale and acquisition finance facilities and also gave us great transparency in valuing our remaining positions

Herbert H. McDade, III, President and COO

Operating Highlights

- 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

Tangible Capital

- We now enter H2 2008 with tangible capital of more than 33B, 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're being responsive to the strong messages from the marketplace, making the necessary adjustments to our platforms

Operational Excellence

- Our definition of operational excellence remain intact
  - First, we're delivering on our client-driven business plan
  - 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

Revenue Potential

- 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 firm can generate mid-teens ROEs
  - We have the team in place, we have the right business model, the will, and the focus to execute

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QUESTION AND ANSWER SECTION

Analyst: *Meredith Whitney – Oppenheimer & Co., Inc*
Question – Meredith Whitney: I wanted to thank you for your extra detail this morning. I have a very basic question surrounding your potential ROEs. And if I just use the revenue numbers that you guys have provided, which is 4B, 4.2B or so, and then the run rate – assuming or not assuming the potential 250mm cost saves, I get to a pre-tax number of around give or take 500, 700mm and then an after-tax per share number of between 40 and $0.45 per quarter. So that would be more suggestive of a mid single digit ROE and mid-teens ROE, and I just want to know if the steps that you're going to take, either on the revenue side or on the cost side, to ensure mid-teens ROE and what timetable we're looking at for that?
Answer – Ian Lowitt: I think I have my microphone on to start off with. That's an improvement. I'm happy to take you through that. I think you're right that if the run rate stayed at 4.2, that wouldn't be consistent with a 15% ROE. In order to get to the 15% ROE given our cost structure, we'd probably need to generate between 4.9 and $5B on a run rate basis. As we think about what that's consistent with, though, we have $33B of leverageable capital. If we maintain our leverage ratio in the low double digits, so call it 12 to 13, we would have net assets of probably 400 to $410B. If you're looking at revenues to assets, you'd need between 4.7 and 4.9 in order to get you to the 4.9 to $5B 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 sheets that we have and historical levels of revenue to assets, you can see how you could get to 4.9 to $5B of quarterly revenues and then when you play that through the comp and NPE, a little bit below a billion dollars 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 and $5B of revenue per quarter – and we're not suggesting that we can get there at this particular quarter, we're really 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 have 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 and [inaudible] equities at something like 1.3B. And then that would require fixed income to generate about 1.8B. The 1.3B for equities, they've been running well above that in 2007, and actually I think the lowest quarter in 2007 was about 1.3B. So you're absolutely right. At the $4.2B of revenue run rate, that's not consistent with a 15% ROE. But as we deploy the extra equity, as we see our capital markets segments getting closer to their historical levels, you can see how we could can get to that.
Question – Meredith Whitney: Okay. So just as a follow-up, if a lot of the revenue scenario then is dependent upon a turnaround in FICC then, could you just 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 FICC for Lehman next quarter, or the next quarter, is it an 2009, '10 projection, just a closer timetable would be appreciated.
Answer – Ian Lowitt: Yes. 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 can't provide you with a specific time of when we think we would get there.

Analyst: *Glenn Schorr – UBS*
Question – Glenn Schorr: It seems like we're at the point now where – okay. Capital and liquidity ratios are fine. But you still have some large illiquid positions. I just want to make sure I heard you correctly where 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, I just want to make sure I heard that part correct.

Answer – Ian Lowitt: 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. And so the combination of those two items, we intend to continue to bring down.

Question – Glenn Schorr: Okay. And then in terms of the -

Answer – Richard Fuld, Jr.: I would only add to that – this is Dick. I would only add to that, we have finished in principle with the deleveraging. But that does not mean that we are finished with changing the mix of the assets.

Question – Glenn Schorr: I'm with you, Dick. I appreciate that.

Answer – Richard Fuld, Jr.: Okay.

Question – Glenn Schorr: 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 vs. your last disclosure at the conference in May?

Answer – Ian Lowitt: 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 off 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 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.

Question – Glenn Schorr: That's good enough. The rating agencies did their thing last month or a couple of weeks ago. And I think from your last Q it said a one more notch downgrade from here would require 5 plus billion 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.

Answer – Ian Lowitt: I think that from the debt holders' perspective, the $6mm of capital raised has improved their position very substantially. You're seeing that coming through in the CDS level. 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 queues 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 that there will be any issues around capital. You've got a sense of just how strong our liquidity position is. And so I think from a debt holders' perspective and the rating agencies' view of that, their real focus is on the power of the franchise to generate high ROEs going forward.

Question – Glenn Schorr: Okay. And last one for Dick. We've talked about 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 to leverage and capital that the industry is allowed to run at? Just something at the very highest level would be interesting.

Answer – Richard Fuld, Jr.: 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'd love to give you an answer on that, but you asked for a high level view and that's probably higher than you wanted, but...

Analyst: *Guy Moszkowski – Merrill Lynch*

Question – Guy Moszkowski: 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 earlier or the latter part of the quarter?

Answer – Ian Lowitt: They were spread over the whole quarter. I mean it was a focus of the entire firm to de-lever 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 that was true across all of the elements, so that would be true within resis, within commercial.

Question – Guy Moszkowski: 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.?

Answer – Ian Lowitt: 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 the write-downs were concentrated in Europe.

Question – Guy Moszkowski: And just to pursue the European piece for a minute. Given that the whole loan sales in Europe were – or the whole loan balance in Europe came down by about 1.4B and 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?

Answer – Ian Lowitt: 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 an incumbent 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 certainly changed the funding characteristics of the position.

Question – Guy Moszkowski: Right, fair enough. Thank you for that. Can you confirm that – I mean I know you talked in some detail about Archstone and SunCal and you gave us good visibility into where those are being carried. But, 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?

Answer – Ian Lowitt: Archstone is held as corporate equity, but the SunCal is held in real estate held for sale.

Question – Guy Moszkowski: Okay. And then finally, last week Erin talked about the firm still expecting to leverage the new capital essentially as 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 are currently carrying?

Answer – Herbert McDade, III: 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.

Analyst: *Prashant Bhatia – Citi*

Question – Prashant Bhatia: Hi. Just on attachment two, the 54B 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 54B is?

Answer – Ian Lowitt: It's all on mark-to-market basis and we feel very good about the valuations. We've had a lot of transparency here in the residential space, in the commercial space as a result of all the sales, so we're very comfortable with our mark-to-markets.

Question – Prashant Bhatia: Okay. I guess what I'm trying to get at is, 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 -

Answer – Ian Lowitt: Oh, I'm sorry, okay, that – thanks for that clarification. I think what we would say is that around the residentials, broadly we're comfortable with the level that we've 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 with the industry averages. With regard to commercials, as I indicated, we still plan to reduce that over the period, but we want to do that in a measured way so 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.

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

Answer – Ian Lowitt: I'm going to have to punt on the elements of that. I think that the – there's an enormous amount of flow through that business, and the 6 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 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 or it was really just part of the normal flow of an extremely robust trading business now.

Question – Prashant Bhatia: 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?

Answer – Ian Lowitt: I suspect 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'd seen in Q1 as the market got comfortable with pricing and transparency and as a result, there was a lot more flow.

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

Answer – Ian Lowitt: 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.

Analyst: *Michael Mayo – Deutsche Bank*

Question – Michael Mayo: I had some follow-ups with regard to attachments 4 through 6, and some of these are detailed but I think very important. First, of the 10B or last quarter 15B of the U.S. Alt-A and prime in the residential mortgage category, how much of that is prime?

Answer – Ian Lowitt: I think the majority of that is Alt-A, Mike.

Question – Michael Mayo: Okay. And of the Triple-A rated securities, how much is super senior vs. mezz? That's the category that went from 6B to 4B.

Answer – Ian Lowitt: I'll have to get back to you on what that breakout is.

Question – Michael Mayo: Can you give any rough sense there, because I think where these securities are trading in the market it makes a difference.

Answer – Ian Lowitt: No, what I can share with you is that those Triple-As are – they're marked in sort of the mid-70s if that helps you.

Question – Michael Mayo: Okay, and the Triple-A rated subprime securities, what vintage are those? Are those 2007 or before 2007?

Answer – Ian Lowitt: I think they're predominantly 2007 because our origination machine was – 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.

Question – Michael Mayo: And then Europe residential mortgage, pretty good sized numbers there. How much of that is prime vs. subprime?

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Answer – Ian Lowitt: I think in my remarks we talked about how much was prime, near prime and nonconforming.
Question – Michael Mayo: Okay.
Answer – Ian Lowitt: It's two-thirds prime and near prime, and about a third nonconforming.
Question – Michael Mayo: And commercial mortgage, of the $5B of securities, how much of that is floating vs. fixed?
Answer – Ian Lowitt: I think that those aren't the securities, guys. We'll have to get back to you with that, Mike.
Question – Michael Mayo: And the mezzanine loans under commercial mortgages, there's 6B there, how much of that is junior vs. senior mezz?
Answer – Ian Lowitt: Again, I'm going to need to get back to you on these things.
Question – Michael Mayo: Okay, I guess the general question is, have you taken sufficient write-downs? So, Dick Fuld, what did it mean when you said you are okay with the valuations at the end of Q2, and are you okay with the valuations today, and can you elaborate on that?
Answer – Richard Fuld, Jr.: What I talked about clearly was the process that we go through. I talked about a 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 markets gave us huge indications. When I say I'm comfortable, understand I am the one that signs the quarterly document.
Question – Michael Mayo: Okay. The reason I ask is there are cases of other top management officials at other companies saying that we're fine, and then the next quarter we had big write-downs again. So what's the likelihood of something like that happening?
Answer – Richard Fuld, Jr.: 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.
Question – Michael Mayo: 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?
Answer – Richard Fuld, Jr.: Am I allowed to answer that? Well, actually before I give the answer I will just say yes, I am.
Question – Michael Mayo: 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 should be.
Answer – Ian Lowitt: And I think, Mike, I think we recognize that we've taken a 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 on 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. The fact that there's so much flow going through gives you a sense of the markets are in fact rating, and there is great price transparency around those, and we are marked to what that set of data is telling us.

Analyst: *William Tanona – Goldman Sachs*
Question – William Tanona: 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 described them being around 38B for this quarter, how much of that 38B 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 move from level 2 to level 3. So if you can provide any type of granularity in terms of where those things are marked presently?

Answer – Ian Lowitt: Let me make a few comments with regard to sort of level three. We did have $40B of level three in Q1, 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 3 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 are seeing in the quarter, it will be down. But I can't quantify for you how much it is down. With regard to the European portfolio, I did indicate to you in the remarks that implicit in where we have valued the European mortgages is 28% a decline in housing prices and what we've seen 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 have seen baked into where we 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 a 30%, but our levels are towards the most conservative end of that.

Question – William Tanona: But you gave with some of the U.S., can you give a level at which you think the reserves are marked on average?

Answer – Ian Lowitt: On the average, I think the position is marked in the low 80s.

Question – William Tanona: 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?

Answer – Ian Lowitt: 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 under deliver. 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 the circumstance like this and so just a little conservative on the unresolved items.

Question – William Tanona: Understandable. And then in terms of the commentary from Dick earlier with securitization origination, leverage loan being less than 10% of revenues in 2007, I guess the question I would have is how did the profitability of those businesses compare, not just to revenues?

Answer – Ian Lowitt: I think the profitability was broadly in line with what the revenue component was.

Question – William Tanona: Okay.

Answer – Richard Fuld, Jr.: 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.

Question – William Tanona: And I guess if you took it as a year later or before in terms of 2006, what would have been kind of the profitability of those businesses in 2006 to exclude those write-downs?

Answer – Richard Fuld, Jr.: I would say – well clearly in 2006, we didn't have the write-downs. But even by the end of 2006, you saw that we began to make adjustments in those mortgage positions, and by 2007 we were already well on to a different model. I think 2006 we were, what, 17 what, 17.7, 17.6? And I think there was probably – it could easily have been 10% of both net income and revenues but then obviously with 2007, a record year, we had none of that. I shouldn't say none of that, we had a de minimis piece of that.

Question – William Tanona: Okay. And then just lastly in terms of 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.

Answer – Ian Lowitt: I think that when you look over the six months, you see very comparable revenue breakouts and composition to what you saw in Q1. So I think that what we've seen is

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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 losses 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.

Analyst: *Douglas Sipkin – Wachovia*
Question – Douglas Sipkin: Just a couple more questions, a little more focused on the revenue side. First off, I now you guys have mentioned several times that you had record prime brokerage revenues. Can you first tell us what you attribute that to and can you provide us some comparison to either last quarter or the y-over-y to put it in some context?
Answer – Ian Lowitt: Yes. 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.
Question – Douglas Sipkin: And can you by any chance put that into some sort of sequential or annual context from a revenue standpoint?
Answer – Ian Lowitt: The revenues are about 5% higher in Q2 than they were in Q1.
Question – Douglas Sipkin: Okay, great. That's helpful. And also, I know – I appreciate you guys put out or you discussed on the call the potential ROE analysis and obviously releveraging some of that capital is part of that. But 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 are anticipating?
Answer – Richard Fuld, Jr.: 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 dark. 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. 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.

Analyst: *Jeffery Harte – Sandler O'Neill*
Question – Jeffery Harte: Can you guys talk a little bit about how you may be approaching the risk management and 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 vs. net exposures, with what the hedges did to you this last quarter?
Answer – Ian Lowitt: 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 naked long 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.
Question – Jeffery Harte: But 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 an aberration of being overly effective?

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Answer – Ian Lowitt: I think we would like to think of the 70% as the level of effectiveness we would want to see, and we would expect of our hedges and it's the last quarter that was the abberative one.
Question – Jeffery Harte: Okay. 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 about 100% full self-financed – I'm sorry, not funded, financed. And how does that compare to historical norms? Is 20% self-financed high, low, normal?
Answer – Ian Lowitt: 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.
Answer – Richard Fuld, Jr.: 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 of protection for Lehman over the commercials vs. high yield.

Analyst: *James Mitchell – Buckingham Research*
Question – James Mitchell: Can we jump back to the revenue run rate for a second? More specifically in equities. Even if you normalize for the private equity the 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 principal side? How do we think about that going forward? And 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?
Answer – Herbert McDade, III: Jeff (sic) [Jim] it's Bart. The equity business had challenging markets, particularly outside of the Americas in Q2. The dynamic in our business's performance was affected 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.
Question – James Mitchell: So did we see that improve in May along with the fixed income?
Answer – Herbert McDade, III: We did. It was really a tale of March and then the other two months for equity franchise, much more normalized run rates.
Question – James Mitchell: Okay. And just a quick update in the first two weeks of June. Obviously very early in the quarter, any kind of thoughts there?
Answer – Ian Lowitt: We've had a good start. It's obviously very early days in the quarter. A couple weeks don't tell you how the whole quarter is going to turn out, but the first couple of weeks have been strong.

Analyst: *David Trone – Fox-Pitt Kelton*
Question – David Trone: 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 end up with your peers regulated like the banks are. Wouldn't that at that point – and again, just hypothetically, wouldn't at that put you have – wouldn't that put the kibosh on the justification for independence? Wouldn't you at that point be motivated to get together with a bank?
Answer – Richard Fuld, Jr.: To begin with, I have said many times that I very much believe that this franchise, 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 with 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 and create more shareholder value than our model can create, I clearly have the obligation to take that to the board and that it's reasonable to be considered. I have always said that. If the model changes so that – I guess your question was banks are the only way

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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.

Analyst: *Michael Hecht – Banc of America*

Question – Michael Hecht: I had one more follow-up on the quality of the marks this quarter. I think you answered it in one of the questions before to Mike's question on where are the cumulative marks on the triple-A piece of the Alt-A book and I'm just trying to get a sense, overall, the overall Alt-A book, what are the cumulative marks? I mean is it marked now down to like $0.70 on the dollar, $0.80 on the dollar? Do you have that?

Answer – Ian Lowitt: It's in the 70s.

Question – Michael Hecht: In the 70s, okay, that's close enough. And then it doesn't like it, but from the client facing revenues you guys went through, but I want to be clear, are you guys seeing any impact of the rumors circulating in the marketplace driving a reduction in client activity or counterparties pulling away from Lehman?

Answer – Richard Fuld, Jr.: We've seen nothing significant across prime broker balances, derivatives, secured lending markets, short end unsecured markets, we've seen nothing insigne significant.

Question – Michael Hecht: Okay, that's helpful. And then you guys know that you brought leverage down here pretty substantially. But can you help us understand how you determine what the right metric leverage is and as part of that I guess, how much of the deleveraging and capital raise going on, is that at the request of regulators vs. trying to allay investor concerns? And then does leverage – defined as assets or net assets over equity – really the right metric since you guys in the industry report your derivatives trading book at fair value vs. the total notional amount?

Answer – Ian Lowitt: Look, I think that 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 sort of too concentrated and diversifying our balance sheet. And so I think that we feel 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 would have in low double digits. 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 CSE 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 what are 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'll continue to be conservative on those metrics as well.

Question – Michael Hecht: Okay. Thanks. And then thanks for the extra color on your repo financing this quarter. I was wondering if it was possible to get a sense of the incremental – or how we should think about the incremental funding costs or maybe terming out some of the facilities you went through?

Answer – Ian Lowitt: I think that in aggregate, our funding businesses are actually making quite a lot more money. So essentially, it's sort of offset in large metric. I mean I think the thing that will affect our overall cost 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 over-funding. And in any event, whatever those costs are, are almost inconsequential in consequence to making sure that the firm is a complete fortress around liquidity.

Question – Michael Hecht: Question on the asset management business, the money fund outflows of 11B 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 inflows and I think the industry data was still strongly positive for Q2. So just any more color on what went on there?

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Answer – Ian Lowitt: No, I don't think so. 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.

Question – Michael Hecht: 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 500mm quarter over quarter when you saw a 1B dollar reduction in revenues if we use your normal run rate, and it gave us 4.2B this quarter and I think it was maybe 5.3B or something last quarter, so did you guys just under accrue last quarter or how do we think about how much flexibility you have?

Answer – Ian Lowitt: 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% ratio. So ex that, I think we're – that's in and around where one would have expected to see an accrual.