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+ Company Note

Lehman Brothers Holdings Inc.

BROKER/DEALER

NYSE: LEH - $7.79

RATING: HOLD
12-Month Price Target: $15.00

September 10, 2008

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MARKET DATA

Market Cap.	$5.4 Bil.
Price/Book	29%
Price/Tang. Book	35%
* As of	08/31/2008
52-Week High	$67.73
52-Week Low	$7.64
3-Mo. Avg. Daily Volume	63,436,308
Dividend Yield	0.64%
Total Assets	$600.0 Bil.
* As of	08/31/2008
ROE	NM
* As of	08/31/2008
ROTE	NM
Shares Outstanding (Mil)	691.2
Annual Dividend	$0.05
Institutional Ownership	63.8%
Insider Ownership	4.0%

Lehman Brothers was founded in 1850 as a commodity trading and brokerage operation. The company primarily provides financial services to its institutional, corporate, government, and high-net-worth individual clients. The company and its affiliates provide a full array of capital market products and advisory services on a worldwide basis through three business segments: Investment Banking, Capital Markets, and Investment Management. Corporate headquarters are in New York City, and the company has over 28,000 employees. LEH generated net income of $4.2 billion on revenue of $19.3 billion in its fiscal year ended November 30, 2007.

3Q08 Preliminary Earnings and Strategic Initiatives - First Look

EPS

	Feb	May	Aug	Nov	Year	Growth	Est. Change	P/E
2007A	$1.96	$2.21	$1.54	$1.54	$7.26	6.6%	—	1.1x
2008E	$0.81A	($5.14)A	($5.92)A	($3.50)	($14.27)	NM	($3.42)	NM
2009E	$0.94	$0.86	$0.77	$0.89	$3.46	—	—	2.3x

- LEH reported a 3Q08 EPS loss of $5.92, versus our estimate of a loss of $2.50, and the consensus of a loss of $3.35. The downside versus our estimate was primarily driven by larger than expected mortgage-related mark-downs (which appear to be at least partially driven by more real estate-related asset sales in the quarter than expected). However, 3Q08 results were of secondary concern versus the simultaneously announced "key strategic initiatives" for the firm.
- The good news is that actual problem asset levels have been reduced by more than we expected and management articulated a plan to bolster the firm's balance sheet.
- The bad news is that problem asset concentrations are still too high and management's articulated plan to strengthen the balance sheet comes with a fair amount of execution risk. Management plans to spin-off the majority of remaining commercial real estate assets into a separate publicly traded company (REI Global) which will be primarily capitalized by the sale of a majority interest in LEH's Investment Management Division (IMD). Unfortunately, the sale of IMD is still a work in progress and we are initially somewhat skeptical of LEH's ability to adequately capitalize REI Global.
- Our estimates and price target are under review. We initially view today's announcements favorably, but concede that there remains a lot of moving parts and execution risk.

Actual 3Q08 results were of secondary concern versus the simultaneously announced "key strategic initiatives" for the firm. LEH reported a 3Q08 EPS loss of $5.92 versus our estimate of a loss of $2.50, and the consensus of a loss of $3.35. The downside versus our estimate was primarily driven by larger than expected "problem asset" related mark-downs. Net mark-to-market write-downs of $5.6 billion exceeded our $3.0 billion estimate. Specifically, net losses on residential mortgage positions totaled $4.9 billion versus our $1.9 billion expectation. The larger than expected losses seemed to be at least partially drive by larger than expected asset sales (see below) as opposed to insufficient previous marks.

Actual problem asset levels have been reduced by more than we expected and the common stock dividend has been cut to conserve capital. The common dividend goes from $0.68 per share to $0.05, which should allow the firm to retain an additional $400-$500 million in earnings each year. While problem asset exposures declined significantly, remaining exposures remain large.

Deleveraging Continues in 3Q08

Asset Balance Sheet Contraction
($ in millions)

	1Q08	2Q08	3Q08
Total Assets	**$786,035**	**$639,000**	**$600,000**
% Change	13.74%	(18.71%)	(6.10%)
Net Assets	**396,673**	**326,899**	**310,915**
% Change	6.36%	(17.59%)	(4.89%)
Residential mortgage-related	**31,800**	**24,900**	**17,200**
% Change	(0.93%)	(21.70%)	(30.92%)
Commercial mortgage and real estate-related investments	**49,000**	**39,800**	**32,600**
% Change	(5.22%)	(18.78%)	(18.09%)
Acquisition Finance Facilties (Funded and Unfunded)	**28,700**	**18,000**	**10,400**
% Change	(19.83%)	(37.28%)	(42.22%)

Source: Sandler O'Neill and Company Reports

Management articulated a plan to bolster the firm's balance sheet. In addition to 3Q08 asset sales and the dividend cut, management's plan includes:

1. The firm plans on spinning off the majority of its CRE assets into a new, separate company, to be completed in 1Q09. Between $25 and $30 billion of CRE assets will be spun-off into Real Estate Investments (REI) Global. Once spun-off, the portfolio will be treated as held-to-maturity and no longer marked-to-market. Preliminarily, it appears that the primary benefit of the spin-out will be that the portfolio will avoid mark-to-market volatility. Management indicated that it believes the underlying fundamentals of its commercial real estate portfolio are significantly better than suggested by current market quotes. Management appears to anticipate capitalizing REI Global by the sale of a majority interest in LEH's Investment Management Division (IMD). We are initially somewhat skeptical of LEH's ability to adequately capitalize REI Global. We will be looking for more clarity from management on how it expects to spin-out approximately $30 billion in real estate related assets from a balance sheet that is leveraged 21:1 into an entity that it expects to have maximum leverage of 4:1 in an extremely tight credit market.

2. Intention to sell a majority stake in their investment management division, while maintaining the majority of its pre-tax income. This includes Neuberger Berman, Private Investment Management, and Private Equity. They plan on selling the division through an auction process, and believe it will improve their tangible book value by more than $3 billion. Unfortunately, the sale of IMD is still a work in progress.

APPENDIX

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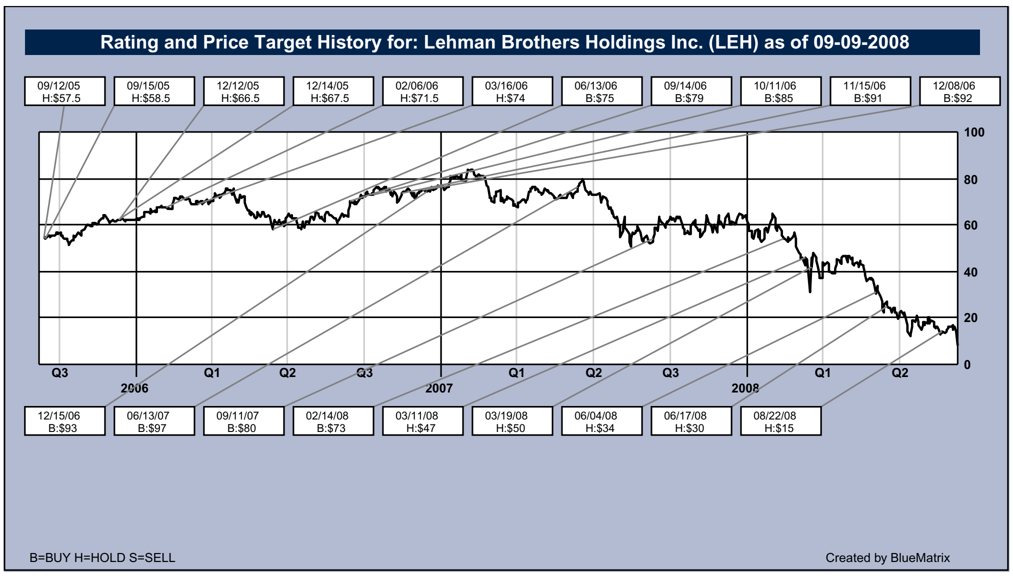

Price Target

Our twelve month price-target is $15.

Valuation Methodology

Our price target represents an absolute price-to book valuation of approximately 0.48 times our 3Q08 book value estimate of $31 per share. This represents 20% of the S&P 500's current multiple of 2.4 times book value, which is in line with LEH's relative price-to-book multiple during September of 1998.

Risk Factors

The primary risk to our price target arises from the possibility of a global economic recession. Additional risks include the potential for continued mark-downs on LEH's financial assets, above-average exposure to significant declines in fixed income capital markets activity, and liquidity risk given the firm's use of repurchase agreements for short-term funding.

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Sandler O'Neill + Partners

			IB Serv./Past 12 Mos.	
Rating	**Count**	**Percent**	**Count**	**Percent**
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