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June 30, 2008

Stock Rating
Overweight

Industry View
In-Line

Lehman Brothers

Bruised, Not Broken — and Poised for Profitability

Initiating at Overweight with a \$31 price target. We think near-term risk of incremental write-downs is balanced by solid liquidity and capital footing. Per our analysis, LEH's discount to book value prices in significant write-downs impairing franchise and profit growth. The firm's ability to weather near-term market headwinds and return to respectable ROE generation should help the shares trade closer to book value. We expect ROE to rise from 3% in 2H08 to 12% in 2009 and 14% in 2010 (even as debt trading declines 28% vs. peak). Medium term, we see optionality to monetize value if franchise and profitability concerns persist in a stabilizing credit environment.

A return to profitability amid a healing credit market should drive valuation close to book value. BV is difficult to pin down, but we believe LEH has sufficient capital to absorb downside risk to our base case write-down estimate. Relative to 2Q08 pro forma BV of \$33 (\$27 tangible), we see downside of 7% in a base case and 15% in a bear case, stemming from write-downs of \$2.5 and \$5.4 billion, respectively. Tail risk has been eliminated by aggressive Fed action and capital raises. Franchise erosion is a real risk, but we view a sale at a discount to BV (as speculated in the media) as improbable. That said, outperformance requires meaningful asset disposition in 2H08 that would allay balance sheet overhang fears.

Franchise value and organic growth help offset 'revenue replacement' concerns. Revenue replacement concerns seem justified long term, but are peripheral to valuation today, in our view. We think even a deteriorating franchise in an improving credit market is worth more than the current share price. While LEH has limited ability to recoup lost revenue from its legacy securitization business, we see more headroom from high-ROE asset management, equities, overseas revenue, plus multi-asset fixed income platform.

Key Ratios and Statistics

Reuters: LEH.N Bloomberg: LEH US

Brokers / United States of America

Price target	\$31.00
Shr price, close (Jun 27, 2008)	\$22.25
Mkt cap, curr (mm)	\$12,444
52-Week Range	\$76.80-20.55

Fiscal Year ending	11/07	11/08e	11/09e	11/10e
ModelWare EPS (\$)	7.26	(3.40)	3.45	4.15

e = Morgan Stanley Research estimates

Quarterly ModelWare EPS

Quarter	2007	2008e		2009e	
		Prior	Current	Prior	Current
Q1	1.96	-	0.81a	-	0.97
Q2	2.21	-	(5.14)a	-	0.81
Q3	1.54	-	0.08	-	0.76
Q4	1.54	-	0.30	-	0.92

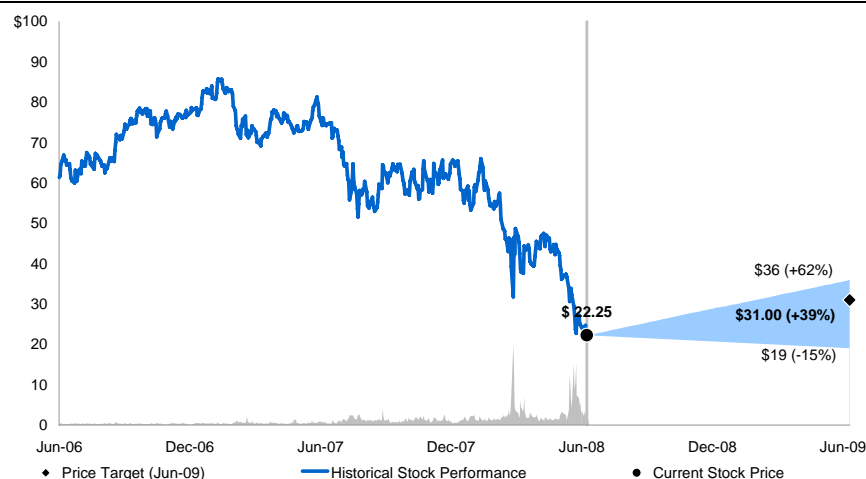
e = Morgan Stanley Research estimates, a = Actual company reported data

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Risk-Reward Snapshot: Lehman Brothers (LEH, \$22, Overweight, PT \$31)

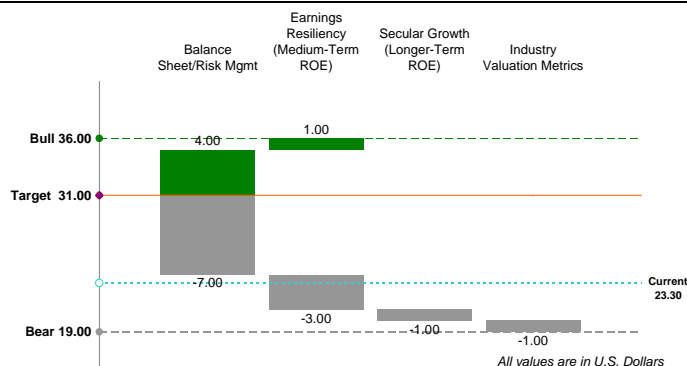
Near-Term Downside Risks Offset Compelling Upside in a Recovery



Source: FactSet, Morgan Stanley Research

Price Target \$31		Equal to 0.9x 12-month forward Stated BV of \$34.48 (0.8x 12-month forward Tangible BV of \$28.73).
Bull Case \$36	1.0x Forward Book Value of \$35.64	Moving on, moving forward. Balance sheet overhang managed down swiftly; core business units support long-term ROE generation. Write-downs (2H08) = \$1.2bn (pretax). Balance sheet/risk mgmt drives \$4/share upside, earnings resiliency, \$1.
Base Case \$31	0.9x Forward Book Value of \$34.48	Write-downs impact book value, but multiple recovers on better visibility. U-shaped progression as near-term write-down overhang in context of uncertain credit markets limit catalysts. Write-downs (2H08) = \$2.5bn (pretax)
Bear Case \$19	0.6x Forward Book Value of \$31.68	BV hits exceed 10%. Balance sheet overhang more intractable than thought, with larger-than-expected near-term hits. Write-downs (2H08) = \$5.4bn (pretax). Balance sheet/risk mgmt drives \$7/share downside; earnings resiliency, \$3; secular growth and valuation, \$1 each

Bear to Bull: Balance Sheet and Valuation Metrics Key Catalysts



Note: Scenario inputs correspond with key investor debates (but as they relate to LEH): balance sheet/risk management, revenue resiliency (near-term ROE), secular growth/competitive environment (normalized ROE), and investor confidence in broker valuation inputs (Book Value, ROE).
Source: Morgan Stanley Research

Investment Thesis

- A return to profitability — in the context of a healing credit market backdrop — should be sufficient to drive valuation closer to book value.
- Meanwhile, aggressive Fed moves (i.e., PDCF) and adequate capital cushion should help the firm weather near-term headwinds stemming from balance sheet overhang.
- Longer term, revenue replacement worries appear justified, but they are peripheral to the current valuation story.

Key Value Drivers

- Timing and magnitude of asset sales (and potential valuation hits) stemming from illiquid asset overhang.
- While write-downs/deleveraging will obscure bottom-line results in 2008, sense for “normalized” run-rate visibility should bolster confidence in sustainable earnings power.

Potential Catalysts

- Credit markets beta: healing will aid deleveraging/asset wind-down, while nasty after-shocks will of course raise level of difficulty on this front.
- 2H08 EPS releases should help investors mark balance sheet repair efforts to market environment.
- Meaningful asset disposition that would allay fears regarding balance sheet overhang (i.e., potential partnership with a strategic investor to manage illiquid overhang, curbing firm's risk)

Investment Case

Bears on Lehman question the sustainability of the franchise. The key debate pivots on balance sheet overhang, reflecting concerns that illiquid mortgage exposure is vulnerable to significant impairment that would drive a retrenchment in balance sheet, eroding the profitability of a franchise already vulnerable to a decline in its core fixed income business lines. LEH is a show-me story, and we do not expect investors to pay up for profit resiliency today, especially as management credibility has suffered by the firm's decision to try to ride out its significant mortgage exposures earlier this year. However, we think this misses the point.

Our thesis is that LEH can weather near-term conditions. Incremental write-downs should limit book value growth through year-end, but we believe Lehman has raised sufficient capital to absorb expected losses over the next two quarters. Further, the Fed's Primary Dealer Credit Facility (PDCF) eliminates significant tail risk. While this facility will presumably not be around forever, it can be reintroduced if market conditions warrant. In any case, in consultation with the Fed, LEH and its peers have been aggressively stockpiling liquidity in the wake of the collapse of Bear Stearns.

The franchise is vulnerable, but near-term concerns appear overdone. Assuming balance sheet exposures are not crippling, we believe downside risk stems from medium-term damage to the franchise rather than a Bear Stearns-like run-on-bank scenario. We see a forced fire sale at a distressed discount to book value as highly improbable, and thus see little reason for the firm to explore a sale at this juncture.

We believe the firm can create shareholder value by returning the franchise to profitability in 2009 after visibility on asset exposures improves. At that stage — and presumably at a valuation above book value in a more accommodative environment — we could imagine a more productive debate on the long-term profitability of the franchise. In any event, we think a deteriorating franchise in an improved credit market is worth comfortably more than what the market is paying today.

Key risks appear overly discounted in valuation. We believe the current P/B of 0.72x (0.89x on tangible BV) discounts significant additional write-downs that would impair Lehman's ability to generate double-digit ROE in a more normalized environment. However, we expect Lehman to

return to double-digit ROE in 2009–10, although at levels considerably below recent peak-of-cycle returns.

Two Key Investment Dynamics

We highlight two key investment dynamics regarding Lehman Brothers. Please see our industry report for additional analysis on outlook and valuation (*The Broker-Dealer is Dead; Long Live the Broker-Dealer*, June 30, 2008).

Too little capital for risk overhang, but too much capital for normalized returns?

- **Our take:** We see downside risk to BV of 7% in a base case and 15% in a bear case, stemming from (pre-tax) write-downs of \$2.5 billion and \$5.4 billion, respectively. We believe the firm has sufficient capital to weather write-downs, although in our bear case scenario an incremental \$1.2 billion in capital would be needed to keep leverage at or below 22x, all else equal.

Lehman is more than a 'bond house,' but we see no 'quick fix' for revenue losses, at least near term.

- **Our take:** We estimate that securitization/mortgage revenue accounted for on average 20% of firm-wide revenue in 2004–06 (contributing over 40% of growth in FICC business during that period). We concede that much of this revenue is gone for good and will not be easily replaced, but we believe the firm has sufficient product breadth to sidestep outsized underperformance vs. peers in a challenging cyclical backdrop.

1. Too little capital for risk overhang, but too much capital for normalized returns?

The question is, How much capital is sufficient for illiquid balance sheet exposures, and does this capital impair Lehman's ability to produce normalized returns in a recovery?

We view valuation through the prism of ROE. A host of factors, including asset sales, capital raises, write-downs in the mortgage inventory, and cyclical headwinds in higher-margin businesses will dampen ROE over the next 1–2 years.

ROE forecast: 2.9% in 2H08, 12% in 2009, 14% in 2010. Looking beyond our write-down-laden 2H08 ROE forecast of 3%, we expect ROE to fall from 20%-plus in 2006–07 to 12% in 2009, before rebounding to 14% in 2010.

June 30, 2008
Lehman Brothers

Adjusting 1H08 run-rate business returns (ex-write-downs, severance, and giving effect to targeted non-comp cost saves), we estimate LEH could produce an ROE of 21.6%. However, if we adjust this figure to reflect higher capital levels/lower leverage (in the wake of write-downs, asset sales and recapitalizations), we arrive at 1H08 ROE of 19.2%.

Clearly, upside leverage from current levels is premised on a cyclical recovery. Cost levers are less plentiful than might be otherwise assumed. We believe meaningful cost saves will be difficult to implement in the current environment given the higher costs involved in motivating and retaining top performers. Understandably, franchise preservation may take precedence over pretax margins in the current environment.

We outline estimated segment ROE contributions to illustrate that a significant revenue mix shift away from fixed income, even while returns in this business decline meaningfully, can support a mid-teens ROE. This analysis reflects a higher equity base and lower leverage for 2010e, but is also premised on a modest cyclical recovery beginning in 2H09.

A high-single-digit/low-teen ROE translates to a price-to-book of 1.0–1.2x, a significant discount to the peer group (GS, MER, and MS). After closing the ROE gap vs. peers over much of the decade, LEH's valuation finally began to reflect the improvement in the franchise's relative ROE standing. After Bear Stearns, everything unraveled on this front given LEH's balance sheet overhang in the context of its size and business mix. At the end

Exhibit 1

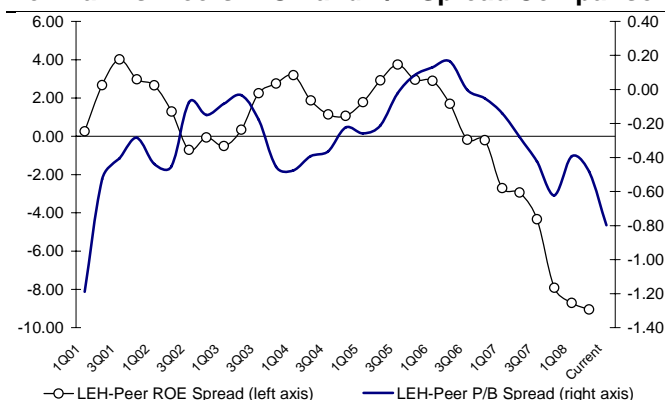
Getting Back to 'Normalized' ROE

	2004-06 Average			2010 Estimate		
	Revenue Contribution	ROE Estimate	Implied ROE Contribution	Revenue Contribution	ROE Estimate	Implied ROE Contribution
Debt Trading	49%	18%	11.3%	31%	6%	4.0%
Equity Trading	18%	25%	4.0%	30%	25%	4.4%
Investment Banking	19%	27%	2.8%	18%	27%	1.9%
Investment Mgmt	14%	32%	2.9%	22%	32%	3.4%
Implied ROE			21.0%			13.7%

Source: Company data, Morgan Stanley Research Morgan Stanley Research estimates

Exhibit 2

Lehman vs. Peers: ROE and P/B Spread Comparison



Note: Median group ROE is 12-months trailing (adjusted for negative ROE quarters). Peers include GS, MER, and MS.
Source: Company data, Morgan Stanley Research

of 2Q08, the trailing 4-quarter spread differential between LEH and peer ROE was –9.1 points, while the P/B differential was –0.5 points (though closer to –0.8 points today).

Balance sheet finally begins to come down

Lehman has finally taken steps to bring down the size of its balance sheet. While a rapid decline in leverage in conjunction with new capital raises will take a bite out of ROE, we see the potential for improving asset yields in a normalized environment. Importantly, we believe much of the deleveraging has already occurred, with total assets poised to decline only modestly in next several quarters.

Exhibit 3

Lehman Balance Sheet Forecast (2008–10E)

	2H08 Impact			Outlook			Level III Assets		Illiquid Assets (2)	Memo:	
	2Q08A PF (1)	Illiquid Assets	Other	4Q08E	2009E	2010E	As of 1Q08	% of Assets		2Q07	1Q08
Assets	639	(40.9)	64.0	662	710	749	38	5.9%	75	606	786
Equity	32.3	(1.6)	1.6	32.3	35.0	37.1				21.1	24.8
Leverage	19.8x			20.5x	20.3x	20.2x				28.7x	31.7x

Memo: 2Q07 serves as proxy for "pre-crisis" period
(1) 2Q08 Pro forma includes \$4b common stock and \$2b convertible preferred stock offering on June 9th, 2008.
(2) Illiquid assets include CMBS, Commercial Real Estate, Alt-A, ABS CDO and LBO assets

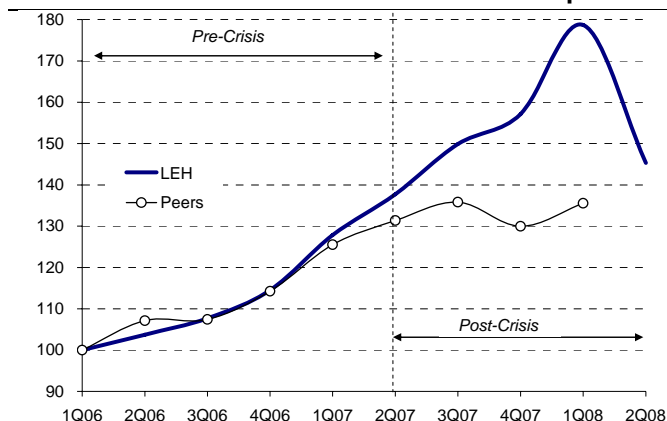
Source: Company data, Morgan Stanley Research E = Morgan Stanley Research estimates

Management was slow to derisk. However, LEH's assets continued to grow meaningfully after 2Q07, unlike several of its peers who began to dial back exposures at year-end. Thus, despite the aggressive asset sales in 2Q08, LEH's gross assets are only back to pre-crisis 2Q07 levels. LEH decided it was better to hold on to large swaths of its balance sheet and absorb incremental mark-to-market losses, rather than unload assets at a loss and preclude the opportunity to participate in a valuation recovery. In fact, the firm took this one step further, with management noting on the 1Q08 conference call that they were actually adding certain mortgage assets at the end of 1Q08.

June 30, 2008
Lehman Brothers

Exhibit 4

Lehman vs. Peers: Total Asset Growth Comparison



Note: Indexed at 100 as of 1Q06. Peers include GS, MER, and MS. 2Q08 excludes MER assets

Source: Company data, Morgan Stanley Research

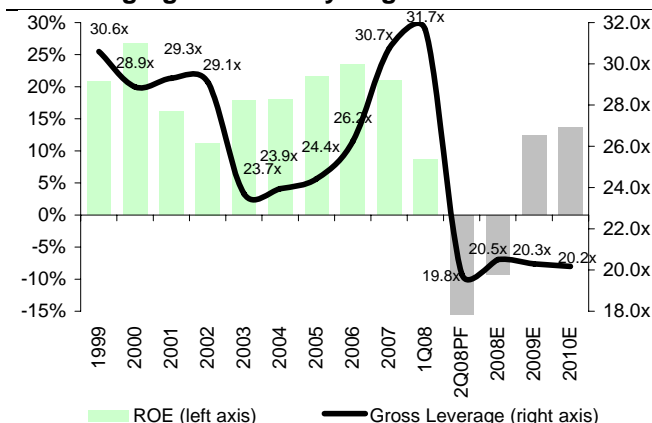
Thus, the recent massive asset drawdown should be viewed in the context of a belated coming to terms with the market backdrop. Asset drawdowns of approximately \$150 billion in 2Q08, along with the raising of \$10 billion in new equity since the end of 1Q08 (\$4 billion of convertible preferred stock on April 1, 2008, a further \$6 billion on June 9, 2008), has accelerated deleveraging at Lehman.

LEH has seen gross leverage rise from 23.7x in 2003 to 31.7x in 1Q08, or ~30%, though still less than the 52% increase seen at peers. At the end of 2Q08, LEH's gross leverage was 25.2x and about 19.8x on a pro forma basis (for \$6 billion equity raise).

We do not expect 2Q08 pro forma leverage to become the new run-rate going forward. We expect Lehman to maintain this ratio near term, but as balance sheet repair and funding sources evolve, LEH will probably be more comfortable taking the ratio higher, particularly against an improving macro backdrop.

Exhibit 5

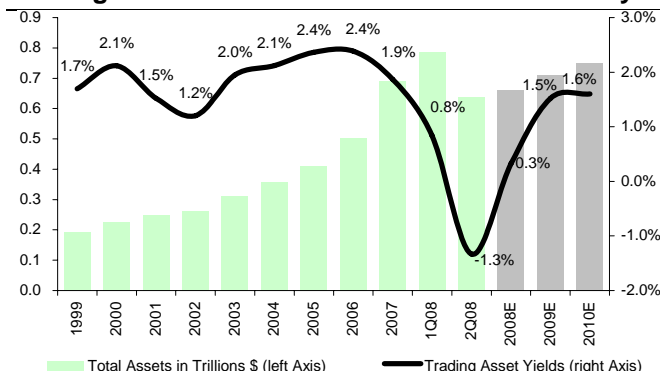
Deleveraging Has Already Begun at Lehman



Note: 2Q08 pro forma for \$6bn equity raise post quarter-end; ROE is -56% for 2Q08PF
Source: Company data, Morgan Stanley Research E = Morgan Stanley Research estimates

Exhibit 6

Trading Asset Yields Recover Over the Next 2-3yrs



Note: 2Q08 pro forma for \$6bn equity raise post quarter-end
Source: Company data, Morgan Stanley Research E = Morgan Stanley Research estimates

Asset overhang ... getting to book value

What is "real" book value after accounting for potential write-downs and incremental capital raise?

We estimate adjusted pro forma BV of \$33.15 is vulnerable to 7% impairment in our base case write-down scenario (we assume no capital raise) and 15% in our bear case scenario (we expect \$1.2 billion capital raise). On a tangible book value basis, potential downside is 8% in our base case and 19% in our bear case vs. pro forma TBV reading of \$27.30.

Through the first two quarters of 2008, LEH recorded net losses of \$2.4 billion related to CMBS and real estate assets (representing a 4.6% gross and net mark on FY07 balances), \$0.9 billion for acquisition finance facilities (4.2% gross, 3.8% net mark), and \$2.8 billion for residential mortgages (16.8% gross, 8.7% net mark).

June 30, 2008
Lehman Brothers

While LEH has been reducing overall exposure to troubled assets, we remain cautious about potential write-downs in the firm's current inventory, which includes: 1) residential mortgages of \$23.9 billion (down 22% from 4Q07), 2) CMBS of \$29.4 billion (down 24%), 3) real-estate of \$10.4 billion (down 19%), and 4) non-investment grade acquisition finance facilities of \$11.5 billion (down 52%).

Lehman also has two outsized exposures, SunCal (held in the real-estate portfolio) and Archstone (held as corporate equity). The firm's \$1.6 billion exposure to SunCal (developers of planned communities in Western US though Lehman's exposure is primarily in Southern California) is currently marked on LEH's books at \$0.70+ on the dollar, while its \$1.8 billion exposure to Archstone (owner of a portfolio of apartment assets and land inventory) is marked at 75% of par (including a negative mark of \$350 million in 2Q08).

In 2Q08, Lehman shed approximately \$147 billion in gross assets, reducing its total asset base by roughly 19%. Of this amount, approximately \$22 billion were in targeted illiquid asset classes, which declined 22% in the aggregate vs. 1Q08. While the firm still has sizable exposures in some asset categories (namely CMBS/LBO/Alt-A), we believe Lehman's ability to aggressively work down these exposures in 2Q08 allows it to be more opportunistic in selling these assets going forward.

While we do not expect asset sales/write-downs to be as large as 2Q08 trends, we do see the firm continuing to reduce commercial real estate exposures with an eye toward bringing down total illiquid assets approximately another \$15–20 billion by year-end. The firm has noted that it expects its residential exposure levels to remain fairly constant (in line with necessary inventory to support trading portfolio), although we would expect mix-shifts across different asset classes within the Resi space in addition to incremental write-downs.

Our base case write-down assumption for the balance of 2008 is \$2.5 billion (pre-tax), composed of \$1.3 billion of losses in the firm's CMBS/real estate portfolio, \$0.5 billion in LBO, and \$0.7 billion across other residential and non-residential mortgage categories. (Please see our industry report published today for an in-depth review of exposures and write-down assumptions across asset classes.)

Our base case implies a 12-month forward BV of \$34.48 and a price/forward BV of 0.65x.

Our bear case assumes net write-downs of \$5.4 billion (pre-tax), resulting in 12-month pro forma of \$31.68 (P/Fwd-BV of 0.70x).

Our bull case write-down estimate of \$1.2 billion (pre-tax) equates to a 12-month pro forma BV of \$35.64 (P/Fwd-BV of 0.62x).

On a pro forma tangible book value basis, we estimate LEH is trading at 0.89x under our base case scenario but approximately 1.00x under our bear case scenario.

We believe tangible book value is less relevant since a significant portion of Lehman's goodwill is due to its purchase of Neuberger Berman in 2003. Since then, the franchise has more than doubled in size, with the value of this business significantly exceeding the ~\$3 billion of goodwill that it is presently carried on the books (we estimate that on a stand-alone basis the firm's current asset management business is worth \$7 billion+).

Exhibit 7

Not Out of the Woods ... Large Exposures Remain

	Writedowns-to-date (net)	Writedowns-to-date (gross)	Exposures (2Q08)
LBO	(1.4)	(2.5)	11.5
CMBS	(1.8)	(1.8)	29.4
Real-estate investments	(0.6)	(0.6)	10.4
Other ABS	(0.4)	(0.5)	6.5
Residential Mortgages	(3.0)	(6.9)	24.9
Total (1)	(8.7)	(15.8)	81.7

Note: Writedowns include losses recorded by LEH from 3Q07 through 2Q08

(1) Total includes \$3.5bn of gross writedowns and \$1.5 billion of net writedowns in 2007 spread across leveraged loans and residential mortgages. Exposures do not include \$1bn in prime mortgages and \$6.5bn in investment-grade acquisition facilities.

Source: Company data, Morgan Stanley Research

June 30, 2008
Lehman Brothers

Exhibit 8

Write-Down Forecast for 3Q08-4Q08E

	Bear ⁽¹⁾	Base ⁽²⁾	Bull ⁽³⁾
Writedown	(5,420)	(2,451)	(1,225)
LBO	(597)	(453)	(227)
CMBS/Real Estate	(2,794)	(1,345)	(672)
Alt-A	(874)	(414)	(207)
ABS CDO/Subprime	(923)	(168)	(84)
Other ABS	(233)	(70)	(35)
After-Tax	(3,594)	(1,625)	(812)
Basic Shares (3Q08E)	702	702	702
Book Value Impact	(\$5.12)	(\$2.31)	(\$1.16)
2Q08 Book Value ⁽⁴⁾	\$33.15	\$33.15	\$33.15
2Q08 Tangible Book Value ⁽⁴⁾	\$27.30	\$27.30	\$27.30
% of Current BV	-15.4%	-7.0%	-3.5%
Pro forma 2Q08 BV	\$28.04	\$30.84	\$32.00
Pro forma 2Q08 TBV	\$22.19	\$24.99	\$26.15
12-mth Forward BV	\$31.68	\$34.48	\$35.64
12-mth Forward TBV	\$25.93	\$28.73	\$29.89
Implied Price/BV			
On Pro forma 2Q08 BV	0.79x	0.72x	0.70x
On Pro forma 2Q08 TBV	1.00x	0.89x	0.85x
On 12-mth Forward BV	0.70x	0.65x	0.62x
On 12-mth Forward TBV	0.86x	0.77x	0.74x

- (1) Assumes "base case" writedown of \$2.5bn plus \$3.0bn in 2H08
(2) Assumes \$2.5bn in 2H08
(3) Assumes only \$1.2bn in net writedowns in 3Q08 and none in 4Q08
(4) Adjusted for the \$4bn common stock offering on 6/9/09

Source: Company data, Morgan Stanley Research E = Morgan Stanley Research estimates

Exhibit 9

LEH Would Need to Raise an Additional \$1.2 billion If Losses Approach Our Bear Case of \$5 Billion

(\$ in millions)

	Base				Bear		
Pretax Writedowns (2H08)	(2,451)	(3,000)	(4,000)	(5,000)	(5,420)	(7,000)	(10,000)
Writedowns (2H08)	(1,625)	(1,989)	(2,652)	(3,315)	(3,594)	(4,641)	(6,630)
Earnings (2H08)	1,956	1,956	1,956	1,956	1,956	1,956	1,956
Net Earnings (2H08)	332	(33)	(696)	(1,359)	(1,637)	(2,685)	(4,674)
Shareholder's Equity (4Q08E)	32,295	31,930	31,267	30,604	30,326	29,278	27,289
Common Equity (4Q08E)	23,302	22,937	22,274	21,611	21,333	20,285	18,296
Equity "Gap" (at 21x leverage)	na	no gap	(262)	(925)	(1,204)	(2,251)	(4,240)
As of 4Q08E:							
Gross Leverage (4Q08E)	20.5x	20.7x	21.2x	21.6x	21.8x	22.6x	24.3x
Pro forma BVPS	\$33.0	\$32.5	\$31.6	\$30.6	\$30.2	\$28.8	\$25.9
Pro Forma Tangible BVPS	\$27.2	\$26.7	\$25.8	\$24.8	\$24.4	\$22.9	\$20.1
P/Forward-BV	0.74x	0.75x	0.77x	0.79x	0.81x	0.85x	0.94x
P/Forward Tangible BV	0.89x	0.91x	0.95x	0.98x	1.00x	1.06x	1.21x

Source: Company data, Morgan Stanley Research E = Morgan Stanley Research estimates

June 30, 2008
Lehman Brothers

Lehman's liquidity position.

Comparisons to Bear Stearns do not hold up. Given LEH's relative size, less diverse revenue composition vs. larger peers, and short-term funding profile, the firm had to contend with heightened scrutiny leading up to and following the liquidity run on Bear Stearns. However, we believe that comparisons to Bear do not hold up, particularly in the wake of the Fed's aggressive action in the wake of Bear's collapse.

Beyond Lehman's comparatively solid liquidity position on a standalone basis, we see the creation of various Fed liquidity facilities, in particular the PDCF, as alleviating liquidity-related issues surrounding the brokers. The PDCF serves as a "backstop" for the group against another "run-on-the-broker" scenario from playing out. Even if it is not accessed directly by the brokers, the facility is helping to restore the market's confidence and, more practically, to drive an orderly deleveraging process by fostering an environment where counterparty credit fears can be removed from credit analysis.

Lehman has made progress on the key measures of liquidity — parent company liquidity and short-term funding. Despite market upheaval, LEH has been able to shore up its liquidity position, increasing parent company liquidity pool to \$45 billion in 2Q08 from \$34 billion in prior quarter, and up from \$29.8 billion in 2Q07. In looking at industry liquidity levels, we place much less stock in "other unencumbered assets," given that these securities can prove more difficult to liquidate in a true liquidity crunch, as we saw in mid-March with BSC.

In terms of unsecured short-term debt (including the current portion of long-term debt) vs. parent liquidity, Lehman's ratio of 1.0x is in line with peer average (lower is better here). Also, its short-term debt as a percentage of unsecured borrowings is at the low end of the peer group (21% vs. 29% for peers). However, this in part owes to the firm's greater reliance on secured borrowings relative to its peer group (evidenced by firm's disproportionate reliance on "repo" funding).

As of 1Q08, repo funding accounted for 5.7x of LEH's liquidity reserve compared to 2.6x for peers (although post 2Q08, we estimate this ratio to be closer to 4.1x). However, as Lehman continues to delever its balance sheet, we would expect this ratio to fall and see a gradual "termining-out" of repo liabilities (and other short-term liabilities).

Exhibit 10

Liquidity Snapshot at 1Q08

	GS	LEH ⁽¹⁾	MER	MS ⁽²⁾
<u>Liability/Funding Structure</u>				
Unsecured Borrowings	252.3	162.8	281.1	261.7
Long-Term Debt	179.5	128.3	186.7	200.3
Short-Term Debt (Incl. Current LTD)	72.8	34.5	94.4	61.3
% ST Debt	29%	21%	34%	23%
Collateralized Financing (Repos)	161.5	197.1	232.5	160.5
Other Secured Borrowings	326.3	276.3	229.3	298.8
Payables	349.2	96.1	152.6	266.6
Deposits	27.0	28.8	104.8	35.7
Equity	42.6	28.8	36.5	33.3
Cash Capital (SE+Deposits+LTD)	249.1	186.0	328.0	269.3
<u>Liquidity Analysis</u>				
Parent Liquidity Reserve	61.2	34.3	82.0	70.0
Other Unencumbered Assets (3)	84.0	64.0	na	na
Total	145.2	98.3	82.0	70.0
Regulated (Not Available to Parent)	na	96.9	128.0	53.0
Total Liquidity (Unreg & Reg)	145.2	195.2	210.0	123.0
% Cash Capital	0.6x	1.0x	0.6x	0.5x
<u>As % Parent Liquidity Reserve</u>				
Short-Term Unsecured Obligations (Scheduled to Mature in 12 mos)	1.2x	1.0x	1.2x	0.9x
Collateralized Financing (Repos)	2.6x	5.7x	2.8x	2.3x
<u>Cash Capital as % of:</u>				
Gross Assets	21%	24%	31%	25%
Adjusted Assets	32%	47%	50%	42%

(1) LEH 2Q08 updates: Collateralized Financing repos = \$188B; Parent liquidity = \$45B and Other Unencumbered Asset = \$87B

(2) MS 2Q08 updates: Parent liquidity = \$80B and Total Liquidity (Unreg and Reg) = \$169B

(3) Unencumbered assets in regulated entities are generally restricted from transfer and therefore considered not available to support the liquidity needs of Parent or other unregulated entities

Source: Company data, Morgan Stanley Research

June 30, 2008
Lehman Brothers

2. Lehman is more than a 'bond house,' but no 'quick fix' for revenue losses, at least near term

The question is, Can Lehman replace revenue from the securitization businesses, which we estimate accounted for north of 20% of firm-wide revenue at market peak (contributing over 40% of fixed income growth in 2003–06)?

Franchise value and organic growth help mitigate, but do not offset, pronounced 'revenue replacement' concerns.

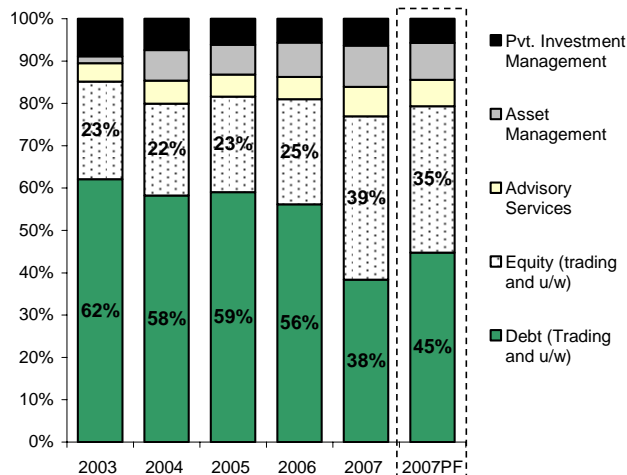
We see no quick fix, but we do see several options over the medium term in an improving environment: broadened debt market revenue mix, asset management revenues, international growth, and continued market share gains from a comparatively small base.

Certainly, LEH has disproportionately benefited from growth in securitization markets, in the context of a business mix more heavily weighted toward fixed income. Given the decline in debt markets activity, "revenue replacement" issues may loom larger at LEH than at other peers; however, we do not believe that the firm is scrambling to identify alternative revenue sources to help alleviate the decline.

Diversification in non-debt markets businesses has long been a strategic goal of LEH... Success on this front can be measured by growth in international and asset management revenue. Further, this diversity is multilayered, as the fixed income footprint has grown to include sizable contributions from FX, prime brokerage, and, more recently, commodities (which help provide product offsets *within* debt markets revenue to declining contribution from securitization).

Exhibit 11

Quit Demeanin' Lehman: Revenue Composition (2003–07)



Source: Company data, Morgan Stanley Research

...but the importance of fixed income at Lehman should not be underestimated. Specifically, the revenues generated by the mortgage and securitization businesses will represent a significant hole to plug going forward. Assuming two-thirds of this revenue is gone, we estimate a \$2.5 billion revenue shortfall.

We estimate that securitization-related underwriting (~\$0.4 billion) and trading (~\$3.1–3.3 billion) accounted for ~\$3.5 billion in annualized revenue at its peak (2005–06), which equated to a little over 20% of firm-wide revenue, or 40–45% of fixed income trading (securitization origination revenues are also booked within fixed income trading). This is significantly more than either our estimates for GS and MER.

Exhibit 12

Est. Securitization/Mortgage Revenue Contribution

Securitization/Mortgage (2004–06)			
	% of Firm Revenues	% of FICC + Debt Underwriting	Growth Contribution (1)
GS	5%	12%	9%
LEH	23%	40%	43%
MER	5%	18%	23%
Total	8%	21%	21%

(1) Growth contribution to FICC and debt underwriting revenues from 2003 through 2006

Note: Firm contribution estimates based in part on investor presentations and Dealogic data

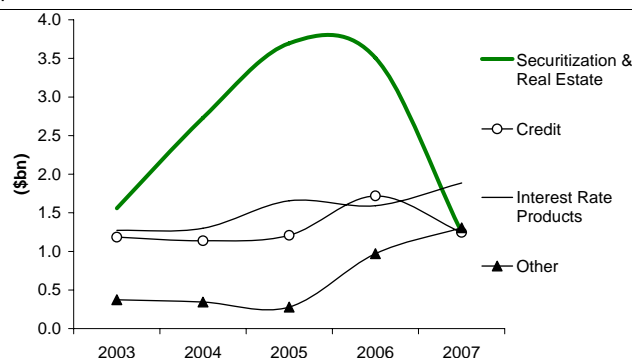
Source: Company data, Morgan Stanley Research E = Morgan Stanley Research estimates

A 2006 investor presentation by LEH revealed that from 2001 to 2005 approximately 67%, or \$3.4 billion, of the revenue *growth* in fixed income trading was driven by the securitization businesses (mortgages, CMBS, ABS, real estate, and structured finance). Extrapolating here, we estimate that between 2004 and 2006, securitization revenues averaged \$3.3 billion annually, then declined to \$1.2–1.4 billion in 2007.

Thus, we see a \$2.5–2.7 billion hole in annualized securitization revenues versus peak 2006 levels

Exhibit 13

Loss of Securitization Trading Revenues Is a \$2.5 billion+ Hole to Fill at Lehman



Estimated fixed income trading revenue mix:						
	2003	2004	2005	2006	2007	
Securitization & Real Estate	36%	48%	50%	42%	21%	
Interest Rate Products	29%	23%	23%	19%	32%	
Credit	27%	20%	16%	20%	21%	
Other (FX, Commodities, Prime Services)	9%	6%	4%	11%	22%	

Source: Company data, Morgan Stanley Research, Lehman Brothers Presentations

June 30, 2008
Lehman Brothers

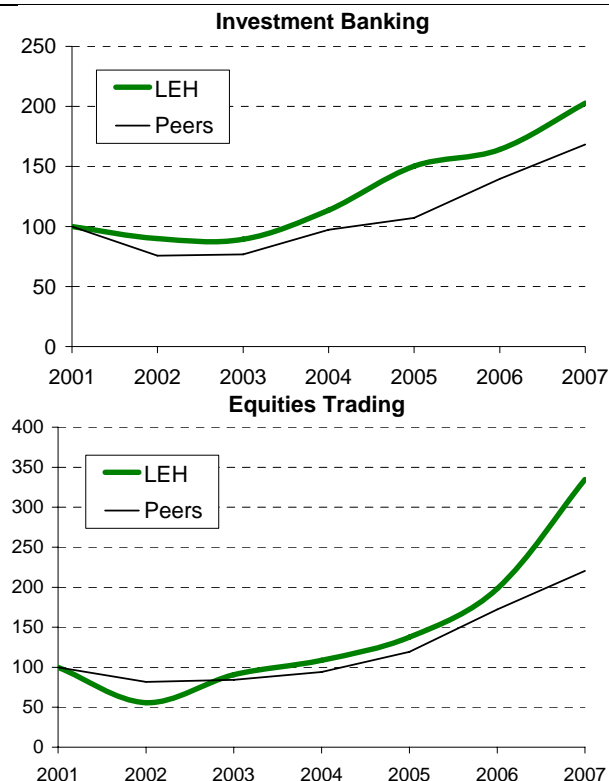
(~23% of firmwide revenue). Our 2009–10 FICC outlook, reflecting the entire firm's fixed income trading franchise, represents an approximate \$2.2–2.3 billion annualized decline vs. peak 2005–06 levels (28% decline).

Diversifying the revenue base. While LEH no longer has the luxury of dipping into the securitization “cookie jar,” it still made impressive strides in diversifying its revenue base, broadening its fixed income footprint, growing its asset management arm (jump started by the Neuberger Berman acquisition, supplemented by growth efforts in alternative investments), and continuing to build out its international footprint.

In addition, Lehman consistently grabbed market share across investment banking and equities from 2001 to 2007. Investment banking revenue at the firm has grown at a CAGR of 12.5% vs. 9.1% for peers while equities has grown at a CAGR of 22.3% compared to 14.1% for peers.

Exhibit 14

I-Banking and Equities Trading Revenue Growth (2001–07)



Note: Peers include C, GS, JPM, MER, and MS. Revenues indexed to 100 in 2001.

Source: Company data, Morgan Stanley Research

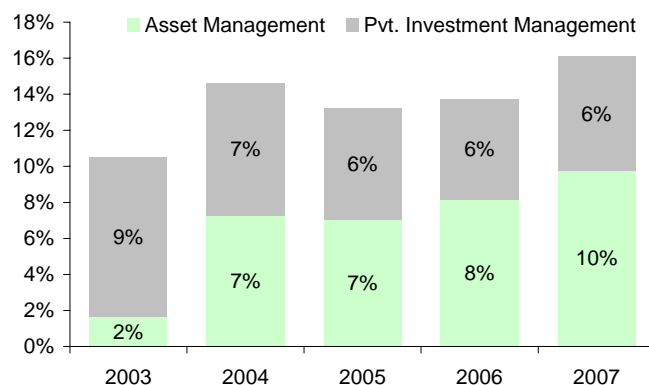
Non-US contributed 49% of 2007 revenues (44% pro forma for US-based write-downs) versus 32% in 2003. In addition, the firm has also actively grown its annuitized, asset-based

revenue streams (asset management and private investment management), which accounted for 16% of revenues in 2007 versus 11% in 2003.

Exhibit 15

Acquisition of Neuberger Berman Vital to Success in Growing Fee-Based Revenues

Alternative Investments Represent the Next Leg Up

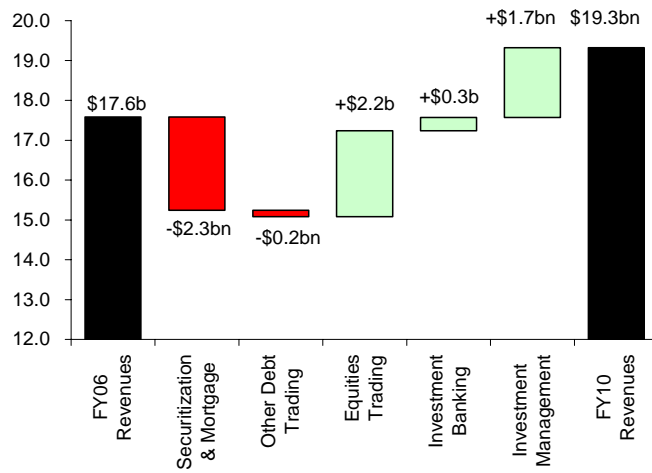


Source: Company data, Morgan Stanley Research

Equities trading and investment management are the key businesses that drive growth over the next 3 years. While we forecast securitization/mortgage related revenues to decline \$2.3 billion in F2010 from F2006 peak levels, we expect this revenue loss to be more than offset by 61% growth in equity trading (or \$2.2 billion) and 72% in investment management (or \$1.7 billion). Bear in mind that this growth is benchmarked to peak 2006 levels, the 1H 2008 run-rate in these businesses already reflect 28% of incremental \$1.7bn in revenue upside targeted for both equities and investment management vs. 2006.

Exhibit 16

Revenue Growth Led by Equities and Investment Management



Source: Company data, Morgan Stanley Research

EPS Outlook

We forecast EPS of **-\$3.40 for 2008, \$3.45 for 2009, and \$4.15 for 2010**, implying 2H 2008 ROE of 3% before slowly “normalizing” to 14% in 2010 (vs. 20–22% in 2005–07).

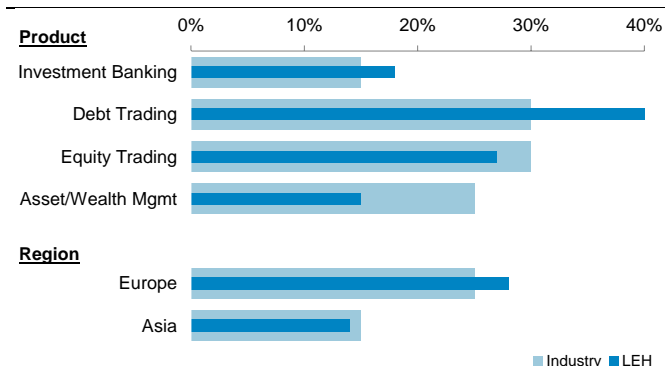
Assumptions for key business segments (with relative weightings and corresponding outlooks summarized below):

- Trading:** Incremental write-downs in debt trading should weigh on results through year-end 2008, before a gradual recovery in normalized results in 2009–10. Our “normalized” fixed income revenue estimate is ~\$6 billion and assumes the firm retains roughly one-third of 2004–07 securitization revenues. In addition, we see market share gains and a diverse equities business helping to partly offset near-term headwinds.
- Investment Banking:** Consistent with our industry outlook, we expect announced volume to rebound in 2009, although owing to lagged nature of deal closings (and revenue recognition), we do not expect M&A to recover until 2010.

- Investment Management:** A targeted strategic growth business for the firm, we expect this business to remain a solid, consistent revenue driver (macro trends permitting). Asset management should continue to benefit from growth in alternative asset classes (including hedge fund and private equity), while retail brokerage should grow at a steady, if unspectacular, clip given equity market headwinds.

Exhibit 17

Normalized Revenue Contribution



Source: Company data, Morgan Stanley Research

Exhibit 18

LEH Summary Outlook 2005–2010E

	2005	2006	2007	2008E	2009E	2010E	Yr/Yr Growth		
							'08/'07	'09/'08	'10/'09
Trading									
Fixed Income	7,334	8,447	5,844	(2,119)	5,404	5,944	nm	nm	10%
Equity	2,473	3,559	6,413	4,300	5,022	5,725	-33%	17%	14%
Total	9,807	12,006	12,257	2,182	10,426	11,669	-82%	378%	12%
Investment Banking									
Debt	1,304	1,425	1,551	1,119	1,103	1,214	-28%	-1%	10%
Equity	824	814	1,015	1,020	1,114	1,281	1%	9%	15%
Advisory	766	921	1,337	1,098	906	996	-18%	-17%	10%
Total	2,894	3,160	3,903	3,237	3,123	3,491	-17%	-4%	12%
Investment Management									
Retail Brokerage	903	985	1,220	1,370	1,411	1,524	12%	3%	8%
Asset Management	1,026	1,432	1,877	2,170	2,362	2,644	16%	9%	12%
Total	1,929	2,417	3,097	3,540	3,773	4,168	14%	7%	10%
Total Net Revenues	14,630	17,583	19,257	8,958	17,321	19,327	-53%	93%	12%
Comp Expenses	7,213	8,669	9,494	7,677	8,626	9,528	-19%	12%	10%
Non-Comp Expenses	2,588	3,009	3,750	4,156	4,143	4,297	11%	0%	4%
Pretax Income	4,829	5,905	6,013	(2,874)	4,552	5,502	-148%	-258%	21%
Taxes	1,569	1,945	1,821	(968)	1,411	1,706	-153%	-246%	21%
Net Income	3,191	3,941	4,125	(2,076)	3,045	3,700	-150%	-247%	22%
EPS	\$5.43	\$6.73	\$7.26	(\$3.40)	\$3.45	\$4.15	-147%	-201%	20%
Shares Outstanding	587.2	578.4	568.3	611.3	882.9	890.9	8%	44%	1%
Key Metrics									
Comp Ratio	49.3%	49.3%	49.3%	85.7%	49.8%	49.3%			
Non-Comp Ratio	17.7%	17.1%	19.5%	46.4%	23.9%	22.2%			
Pretax Margin	33.0%	33.6%	31.2%	-32.1%	26.3%	28.5%			
Book Value	\$28.75	\$33.87	\$39.45	\$33.04	\$35.82	\$38.69	-16%	8%	8%
Common equity	15,699	18,096	21,395	23,302	25,977	28,150	9%	11%	8%
Shareholder's equity	16,794	19,191	22,490	32,295	34,970	37,143	44%	8%	6%
Total Assets	410,063	503,545	691,063	662,113	709,778	749,477	-4%	7%	6%
Adjusted Assets	211,424	268,936	372,959	349,977	377,151	399,498	-6%	8%	6%
ROA	3.8%	3.8%	3.2%	1.3%	2.5%	2.6%			
ROE	21.8%	23.3%	20.9%	-9.3%	12.4%	13.7%			
Gross Leverage	24.4x	26.2x	30.7x	20.5x	20.3x	20.2x	-33%	-1%	-1%
Net Leverage	13.4x	13.8x	15.7x	12.1x	10.4x	10.5x	-23%	-14%	1%

Source: Company data, Morgan Stanley Research E = Morgan Stanley Research estimates

June 30, 2008
Lehman Brothers

Valuation Methodology

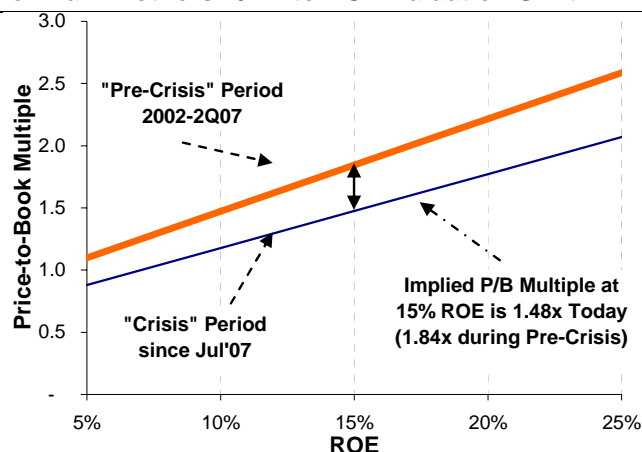
The old valuation playbook is less applicable today. The building blocks of valuation — BV and ROE — are susceptible to eroding investor confidence in the wake of risk breakdowns and an uncertain structural/secular operating environment. While book value and expected ROEs are less reliable today, these metrics still offer the best framework to assess valuation.

Valuation balances near-term headwinds with long-term growth. We expect strong correlation between P/B multiples and forward ROE expectations to hold, but we discount normalized pre-crisis P/B multiple to expected ROE generation for each stock (over the next 12–24 months) by 20% to reflect heightened valuation input uncertainty amid a volatile backdrop.

Below we outline the shift in ROE expectations for LEH vs. P/B valuation, comparing the “normal” pre-crisis period (2002 to June 2007) to more recent valuation readings. Our valuation work assumes a 20% haircut to “normal” P/B to ROE ratio going forward (somewhat less than current discount of approximately ~30%), which we apply consistently for each stock.

Exhibit 19

Lehman Brothers P/BV to ROE Valuation Shift



Note: Peers include GS, LEH, and MER. "Pre-Crisis" period is between 2002-2Q07 and takes the average of the 2yr forward ROE and 1yr forward ROE. (2) Crisis period is Jul'07 through present and applies a 20% discount to the "Normal" curve

Source: Company data, Morgan Stanley Research Morgan Stanley Research estimates

Looking ahead, in determining our measure of fair value, we attempt to reconcile the following:

- Level of appropriate discount to forward book value (i.e., risk of additional write-downs beyond our base case forecast)
- Achievable ROEs over the next 12–24 months
- Multiple of book value investors will pay for these ROEs

Our price targets reflect our estimate of 12-month forward book value per share. We then assign a multiple on this book value based on relative near-term and long-term ROE generation capacity of the firm, in the context of observed historical relationship between each stock's valuation and ROE outlook. This target multiple reflects, where appropriate, incremental asset impairment risk to our outlook (beyond what may already be reflected in our EPS outlook, to avoid double-penalizing).

Exhibit 20

Lehman Brothers Estimate Summary

	2008E	2009E	2010E
MS Est.	-\$3.40	\$3.45	\$4.15
Cons.	-\$3.17	\$3.76	\$4.55
MS vs. Cons	7%	-8%	-9%

Source: FactSet, Morgan Stanley Research

Exhibit 21

Lehman Brothers Valuation Summary

	Current/12-mth Scenario Value				Forward ROE	
	Price	BVPS	P/BV		12-mths	'09E-'10E
			(Fwd)	(Current)		
Current	\$22.25	\$33.15		0.7x		
Base Case	\$31.00	\$34.48	0.9x	0.9x	7.9%	13.0%
Bear Case	\$19.00	\$31.68	0.6x	0.6x	-10.0%	8.0%
Bull Case	\$36.00	\$35.64	1.0x	1.1x	12.0%	17.0%

Source: Company data, Morgan Stanley Research E = Morgan Stanley Research estimates

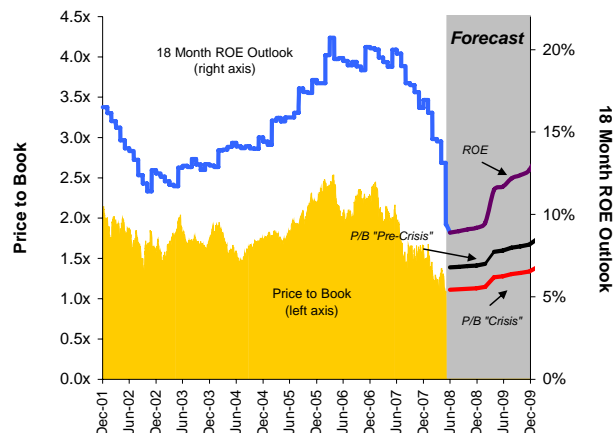
ROE outlook. As discussed above, while we certainly see cyclical challenges ahead, we do not believe a meaningful structural weakening of ROEs stemming from a protracted deleveraging trade is in the offing. We average our near-term ROE outlook (12 months) and normalized franchise ROE (2009–10) to better approximate combination of underlying market outlook as well as longer-term franchise value in an improving environment (a methodology that we believe more fairly approximates historic P/B to ROE relationship, as outlined above during “normal” period).

P/B vs. ROE. Since 2002, LEH's price/book has ranged from approximately 0.8x to 2.5x, corresponding to forward ROEs of 7% to 24%. Breaking this down further, investors are willing to pay on average 2.0x book for just under a 20% forward ROE, equating to approximately 10x P/B to ROE. This ratio fluctuates depending on the point in the cycle. Trough periods witnessed ratios above this range, whereas peak periods such as 1H07 produced ratios below this range (as investors understandably discount the sustainability of either trough- and peak-cycle ROEs).

June 30, 2008
Lehman Brothers

Exhibit 22

Lehman Brothers P/B vs. Forward ROE



Source: Company data, Morgan Stanley Research Morgan Stanley Research estimates

Other Valuation Metrics:

As a check, we supplemented our P/B analysis with additional valuation metrics:

- **Sum-of-the-parts (SOTP):** We valued separate businesses based on the best available publicly traded comps. Our SOTP analysis indicates a valuation of \$35/share, implying a price-to-book of 1.0x (on 12-month forward book value).

However, we caution that this analysis inevitably drives a higher valuation (across the peer group), given the implied discount assigned to the group's less transparent, higher risk and more volatile sales and trading business.

Exhibit 23

Sum-of-the-Parts Values LEH Shares at \$35

Segment	Pretax (2009E)	Industry Multiple	SOTP Value (\$bn)	Per Share	% of Total
Underwriting	419	21.7x	6.3	\$7.1	20%
Advisory	263	11.3x	2.0	\$2.3	7%
Sales & Trading	2,815	6.9x	13.3	\$15.1	43%
Asset Management	661	14.8x	6.7	\$7.6	22%
Wealth Management	254	13.8x	2.4	\$2.7	8%
Total			30.8	\$34.8	

Estimated Writedowns (\$bn)

Base Case	(1.6)	(1.8)
Bear Case	(3.6)	(4.1)

Pro Forma

Base Case	29.1	33.0
Bear Case	27.2	30.8

Industry Multiple Assumptions:

Underwriting	median multiple of mid-cap brokers (JEF, TWPG, COWN, KBW, and PJ)
Advisory	median multiple of M&A boutique firms (LAZ, EVR, and GHL)
Sales and Trading	median multiple of large-investment banks (MS, MER, GS, and LEH)
Asset Management	median multiple of traditional asset managers (BEN, TROW, FIL, LM, JNS)
Wealth Management	median multiple of retail brokers (RJF and SCHW)

Source: Company data, Morgan Stanley Research E = Morgan Stanley Research estimates

- **Residual Income Model (RIM):** Consistent with our colleagues on the Morgan Stanley financials team, we also looked at valuations based on RIM analysis. This analysis yielded a price target closer \$29 (roughly in line with our base case measure of fair value).

Exhibit 24

Residual Income Assumptions

Share Information

Expected 12 Month Dividend	\$0.68
Current Stock Price	\$22.25
Issued Shares, FD (million)	861.8
Pro Forma Book Value Per Share (2Q08)	33.15

Cost of Capital

10-yr. Govt. Bond Yield (%)	5.00
Beta	1.90
Market Risk Premium (%)	4.00
Cost of Common Equity (%)	12.60

Maturity Phase

Number of Years	8
Target Equity/Assets Ratio (%)	4.0
End of Phase Asset Growth Rate (%)	8.0

Decline Phase

Decay Factor (0-10%)	6.0
Growth in Assets (%)	6.0

Fair Value

12 Month Estimate of Fair Value	\$29.01
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(1) Fully diluted for capital raise

Source: Company data, Bloomberg, Morgan Stanley Research estimates

June 30, 2008
Lehman Brothers

Exhibit 19

Lehman Brothers Earnings Model

INCOME STATEMENT	1Q07	2Q07	3Q07	4Q07A	1Q08A	2Q08A	3Q08E	4Q08E	2006	2007	2008E	2009E	2010E	Comparisons			
														YoY Growth			
														'07A	'08E	'09E	'10E
Capital Markets:																	
Fixed Income	2,164	1,891	1,063	727	262	(2,975)	225	370	8,447	5,844	(2,119)	5,404	5,944	-31%	nm	nm	10%
Equities	1,338	1,703	1,372	2,000	1,410	601	1,070	1,220	3,559	6,413	4,300	5,022	5,725	80%	-33%	17%	14%
Total	3,502	3,594	2,435	2,727	1,672	(2,374)	1,294	1,589	12,006	12,257	2,182	10,426	11,669	2%	-82%	378%	12%
Investment Banking:																	
Global Finance - Debt	428	540	350	233	322	288	252	257	1,425	1,551	1,119	1,103	1,214	9%	-28%	-1%	10%
Global Finance - Equity	175	333	296	210	215	330	250	225	814	1,015	1,020	1,114	1,281	25%	1%	9%	15%
Advisory Services	247	277	425	388	330	240	238	290	921	1,337	1,098	906	996	45%	-18%	-17%	10%
Total	850	1,150	1,071	831	867	858	740	772	3,160	3,903	3,237	3,123	3,491	24%	-17%	-4%	12%
Investment Management																	
Asset Management	416	460	468	533	618	496	518	538	1,432	1,877	2,170	2,362	2,644	31%	16%	9%	12%
Private Investment Management	279	308	334	299	350	352	345	323	985	1,220	1,370	1,411	1,524	24%	12%	3%	8%
Total	695	768	802	832	968	848	863	861	2,417	3,097	3,540	3,773	4,168	28%	14%	7%	10%
Total net revenues	5,047	5,512	4,308	4,390	3,507	(668)	2,897	3,222	17,583	19,257	8,958	17,321	19,327	10%	-53%	93%	12%
Non-Interest Expense Items:																	
Comp/Net Rev Ratio	49.3%	49.3%	49.3%	49.3%	52.5%	-348.1%	60.0%	55.0%	49.3%	49.3%	85.7%	49.8%	49.3%				
Compensation and Benefits	2,488	2,718	2,124	2,164	1,841	2,325	1,738	1,772	8,669	9,494	7,677	8,626	9,528	10%	-19%	12%	10%
Non-Comp Expenses	860	915	979	996	1,003	1,094	1,021	1,038	3,009	3,750	4,156	4,143	4,297	25%	11%	0%	4%
Non-Comp/Net Rev Ratio	17.0%	16.6%	22.7%	22.7%	28.6%	-163.8%	35.2%	32.2%	17.1%	19.5%	46.4%	23.9%	22.2%				
Technology/Communication	266	287	282	311	302	309	310	310	974	1,145	1,231	1,247	1,272	18%	8%	1%	2%
Brokerage, Clearing and Distribution Fee	194	201	224	240	253	252	249	264	630	859	1,019	1,015	1,056	36%	19%	0%	4%
Occupancy	146	152	170	173	185	188	184	182	539	641	740	729	758	19%	15%	-1%	4%
Business Development	84	100	91	103	89	87	87	89	301	378	352	383	410	26%	-7%	9%	7%
Professional Fees	98	120	128	120	98	100	100	102	363	466	400	429	437	28%	-14%	7%	2%
Other	72	55	84	49	76	158	90	90	202	261	414	340	364	29%	59%	-18%	7%
Total Non-Interest Expenses	\$3,348	\$3,633	\$3,103	\$3,160	\$2,844	\$3,419	\$2,759	\$2,810	\$11,678	\$13,244	\$11,832	\$12,769	\$13,826	13%	-11%	8%	8%
Pretax Income	1,699	1,879	1,205	1,230	663	-4,087	138	412	5,905	6,013	-2,874	4,552	5,502	2%	nm	nm	21%
Provision for Income Taxes	553	606	318	344	174	-1,313	43	128	1,945	1,821	-968	1,411	1,706	-6%	nm	nm	21%
Tax Rate	32.5%	32.3%	26.4%	28.0%	26.2%	32.1%	31.0%	31.0%	32.9%	30.3%	33.7%	31.0%	31.0%				
Operating Income before Pref. Dividends	1,146	1,273	887	886	489	-2,774	95	284	3,960	4,192	-1,905	3,141	3,796	6%	nm	nm	21%
Preferred Dividends	17	17	17	16	24	99	24	24	66	67	171	96	96	2%	155%	-44%	0%
Operating Income	1,129	1,256	870	870	465	-2,873	71	260	3,894	4,125	-2,076	3,045	3,700	6%	nm	nm	22%
Extraordinary Items	0	0	0	0	0	0	0	0	47	0	0	0	0				
Net Income (Reported)	\$1,129	\$1,256	\$870	\$870	\$465	-\$2,873	\$71	\$260	\$3,941	\$4,125	-\$2,076	\$3,045	\$3,700	5%	nm	nm	22%
Operating EPS	\$1.96	\$2.21	\$1.54	\$1.54	\$0.81	-\$5.14	\$0.08	\$0.30	\$6.73	\$7.26	-\$3.40	\$3.45	\$4.15	8%	nm	nm	20%
Share Count																	
Avg. Diluted Shares	575.4	568.1	565.8	563.7	572.8	559.3	861.8	865.4	578.4	568.3	611.3	882.9	890.9	-2%	8%	44%	1%
EOP Basic Shares	534.9	530.2	529.4	531.9	551.4	559.3	702.3	705.3	533.4	531.9	705.3	719.5	727.6	0%	33%	2%	1%
Key Metrics																	
Return on Equity	24.4%	25.8%	17.1%	16.6%	8.6%	nm	1.3%	4.5%	23.3%	20.9%	-9.3%	12.4%	13.7%				
Return on Tangible Equity	30.0%	31.6%	21.1%	20.6%	10.6%	nm	1.7%	5.5%	29.0%	25.8%	5.9%	14.8%	16.1%				
Pretax Profit Margin	33.7%	34.1%	28.0%	28.0%	18.9%	nm	4.8%	12.8%	33.6%	31.2%	-32.1%	26.3%	28.5%				
Net Profit Margin	22.4%	22.8%	20.2%	19.8%	13.3%	nm	2.5%	8.1%	22.4%	21.4%	-23.2%	17.6%	19.1%				
Book Value / Share	\$35.15	\$37.15	\$38.29	\$39.45	\$39.45	\$34.21	\$32.91	\$33.04	\$33.87	\$39.45	\$33.04	\$35.82	\$38.69	16%	-16%	8%	8%
Tangible Book Value / Share	\$28.75	\$30.90	\$31.22	\$32.46	\$32.15	\$27.12	\$27.05	\$27.21	\$27.62	\$32.46	\$27.21	\$30.15	\$33.04	18%	-16%	11%	10%
Gross Leverage (Assets / Equity)	28.1x	28.7x	30.3x	30.7x	31.7x	24.3x	20.2x	20.5x	26.2x	30.7x	20.5x	20.3x	20.2x	17%	-33%	-1%	-1%
Net Leverage	15.4x	15.3x	16.1x	16.0x	15.4x	12.0x	10.3x	10.6x	13.8x	15.7x	12.1x	10.4x	10.5x	14%	-23%	-14%	1%

Source: Company data, Morgan Stanley Research E = Morgan Stanley Research estimates

June 30, 2008
Lehman Brothers

Exhibit 19

Lehman Brothers Balance Sheet

	1Q07	2Q07	3Q07	4Q07	1Q08A	2Q08A	3Q08E	4Q08E	2005	2006	2007E	2008E	2009E	2010E
ENDING BALANCE SHEET														
<i>Assets</i>														
Customers	21,459	26,924	25,229	29,622	37,298	34,900	36,967	40,761	12,887	18,470	29,622	40,761	46,876	51,303
Brokers, Dealers and Clearing Organizations	7,266	7,365	10,518	11,005	11,915	11,149	11,809	13,021	7,454	7,449	11,005	13,021	14,975	16,389
Other	<u>2,285</u>	<u>2,859</u>	<u>2,644</u>	<u>2,650</u>	<u>3,186</u>	<u>2,981</u>	<u>3,158</u>	<u>3,482</u>	<u>1,302</u>	<u>2,052</u>	<u>2,650</u>	<u>3,482</u>	<u>4,004</u>	<u>4,382</u>
Total Receivables	31,010	37,148	38,391	43,277	52,399	49,030	51,934	57,265	21,643	27,971	43,277	57,265	65,854	72,074
Total Financial Instruments	256,638	285,684	302,297	291,212	326,658	266,226	268,889	271,577	177,438	226,596	291,212	271,577	288,228	302,640
<i>Sequential Growth</i>	13.3%	11.3%	5.8%	-3.7%	12.2%	-18.5%	1.0%	1.0%	0	0	(0)	-7%	6%	5%
Cash and Equivalents	4,116	5,293	7,048	7,286	7,564	10,165	10,266	10,369	4,900	5,987	7,286	10,369	11,005	11,555
Cash/Securities Segregated and on Deposit for Regulatory Purpose:	6,293	7,154	10,579	12,743	16,569	15,504	16,422	18,108	5,744	6,091	12,743	18,108	20,824	22,791
Securities Purchased Under Agreements to Resell	131,896	130,953	144,774	162,635	210,166	171,285	172,998	174,728	106,209	117,490	162,635	174,728	185,441	194,713
Securities Received as Collateral	6,847	8,317							4,975	6,099	0	0	0	0
Securities Borrowed	112,919	118,118	142,653	138,599	158,515	112,919	114,048	115,188	78,455	101,567	138,599	115,188	122,251	128,363
Property, Equipment and Leasehold Improvements	3,398	3,519	3,677	3,861	4,189	4,273	4,294	4,359	2,885	3,269	3,861	4,359	4,695	5,164
<i>Sequential Growth</i>	3.9%	3.6%	4.5%	5.0%	2.1%	2.0%	0.5%	1.5%	-3%	13%	5%	13%	8%	10%
Identifiable Intangible Assets and Goodwill	3,531	3,652	4,108	4,127	4,112	4,112	4,112	4,112	3,256	3,362	4,127	4,112	4,112	4,112
Other Assets	5,635	6,023	5,689	27,323	5,863	5,486	5,811	6,407	4,558	5,113	27,323	6,407	7,369	8,065
Total Assets	562,283	605,861	659,216	691,063	786,035	639,000	648,774	662,113	410,063	503,545	691,063	662,113	709,778	749,477
Memo: Net Leverage Ratio	15.4	15.3	16.1	16.0	15.4	12.0	10.3	10.6	13.6	14.5	16.0	10.6	10.5	10.5
<i>Liabilities</i>														
Short-Term Debt and Current Portion of Long Term Debt	23,997	27,712	26,314	28,066	34,524	27,790	27,969	28,565	2,941	20,638	28,066	28,565	30,606	32,308
Financial Instruments Sold but Not Repurchased									0		0		0	
Total	140,903	168,015	140,840	149,617	196,903	158,495	159,516	162,917	110,577	125,960	149,617	162,917	174,555	184,262
Obligation to Return Securities Received as Collateral	6,847	8,317	0	0					4,975	0	0	0	0	0
Collateralized Borrowings									0		0			
Securities Sold Under Repo Agreements	153,332	137,948	169,302	181,732	197,128	158,677	159,698	163,103	116,155	133,547	181,732	163,103	174,754	184,472
Securities Loaned	15,891	27,942	60,491	53,307	54,847	44,149	44,433	45,380	13,154	23,982	53,307	45,380	48,622	51,326
Other Secured Borrowings	23,599	26,639	26,284	22,992	24,539	19,752	19,880	20,304	23,116	19,028	22,992	20,304	21,754	22,964
Payables:									0		0			
Customers	64,101	69,670	74,014	90,569	101,664	81,834	82,360	84,117	47,210	63,107	90,569	84,117	90,125	95,137
Brokers, Dealers and Clearing	10,006	2,498	2,750	3,101	11,717	9,432	9,492	9,695	1,870	2,217	3,101	9,695	10,387	10,965
Accrued Liabilities and Other Payables	12,827	15,172	17,157	16,039	11,596	9,334	9,394	9,595	10,962	14,697	16,039	9,595	10,280	10,852
Long Term Debt:									0		0			
Senior Notes	87,762	96,298	115,792	118,173	123,309	98,286	98,951	101,167	60,283	78,440	118,173	101,167	108,749	115,073
Junior Subordinated Notes	3,013	4,521	4,539	4,977	4,976	4,976	4,976	4,976	2,026	2,738	4,977	4,976	4,976	4,976
Total Long Term Debt	<u>90,775</u>	<u>100,819</u>	<u>120,331</u>	<u>123,150</u>	<u>128,285</u>	<u>103,262</u>	<u>103,927</u>	<u>106,143</u>	<u>62,309</u>	<u>81,178</u>	<u>123,150</u>	<u>106,143</u>	<u>113,725</u>	<u>120,049</u>
Total Liabilities	542,278	584,732	637,483	668,573	761,203	612,724	616,668	629,818	393,269	484,354	668,573	629,818	674,808	712,334
									0		0			
									0		0			
<i>Shareholders' Equity</i>														
Common Stockholders' Equity	18,910	20,034	20,638	21,395	21,839	19,283	23,113	23,302	15,699	18,096	21,395	23,302	25,977	28,150
Total Shareholders' Equity	20,005	21,129	21,733	22,490	24,832	26,276	32,106	32,295	16,794	19,191	22,490	32,295	34,970	37,143
Tangible Equity Capital	19,487	21,998	22,164	23,340	25,696	27,140	32,970	33,159	15,564	18,567	23,340	33,159	35,834	38,007
Tangible Shareholders' Equity	15,379	16,382	16,530	17,268	17,727	15,171	19,001	19,190	12,443	14,734	17,268	19,190	21,865	24,038
Total Liabilities and Equity	562,283	605,861	659,216	691,063	786,035	639,000	648,774	662,113	410,063	503,545	691,063	662,113	709,778	749,477

Source: Company data, Morgan Stanley Research E = Morgan Stanley Research estimates

June 30, 2008
Lehman Brothers

Exhibit 19

Global Brokers Valuation

Company	Ticker	Ccy	Rating	Price Target	Pricing				Earnings & Book Value					Valuation (Price to)					MS Coverage Analyst	
					Price 6/29/08	Market Cap.	Performance YTD	Performance LTM	2008E EPS	2009E EPS	2010E EPS	BVPS	Tang. BVPS	2008E EPS	2009E EPS	2010E EPS	Current BVPS	TBV		
Investment Banks ⁽¹⁾																				
Goldman Sachs	GS	USD	OW	205	174.56	68,812	-19%	-19%	15.75	18.75	22.55	97.5	85.2	11.1x	9.3x	7.7x	1.8x	2.0x	PP	
Lehman Brothers	LEH	USD	OW	31	22.25	12,298	-66%	-70%	-3.40	3.45	4.15	33.2	27.3	-6.5x	6.4x	5.4x	0.7x	0.8x	PP	
Merrill Lynch	MER	USD	EW	NA	32.70	32,138	-39%	-61%	-2.28	4.00	4.70	28.9	24.4	-14.3x	8.2x	7.0x	1.1x	1.3x	PP	
Morgan Stanley	MS	USD	NC	NC	36.71	40,706	-31%	-56%	4.47	5.63	6.75	30.1	26.6	8.2x	6.5x	5.4x	1.2x	1.4x	NC	
Median							-35%	-59%						0.8x	7.4x	6.2x	1.2x	1.4x		
U.S. Large-Cap Banks																				
Bank of America	BAC	USD	EW	33	24.59	109,494	-40%	-50%	2.71	3.92	5.45	31.2	11.5	9.1x	6.3x	4.5x	0.8x	2.1x	BG	
Citigroup	C	USD	UW	18	17.25	87,734	-41%	-66%	-0.72	2.10	3.37	20.8	8.6	-23.9x	8.2x	5.1x	0.8x	2.0x	BG	
JPMorgan	JPM	USD	OW	42	35.05	120,103	-20%	-28%	2.60	3.64	5.34	36.9	21.8	13.5x	9.6x	6.6x	0.9x	1.6x	BG	
Median							-40%	-50%						9.1x	8.2x	5.1x	0.8x	2.0x		
European Banks																				
Credit Suisse	CSGN.VX	CHF	OW	63	46.90	53,453	-31%	-46%	5.28	6.17	7.40	36.9	27.0	8.9x	7.6x	6.3x	1.3x	1.7x	HVS	
Deutsche Bank	DBGn.DE	Euro	EW	79	55.51	46,385	-38%	-49%	8.12	7.96	9.08	70.2	51.9	6.8x	7.0x	6.1x	0.8x	1.1x	HVS	
UBS	UBSN.VX	CHF	EW	32	22.40	64,405	-52%	-66%	2.30	2.99	3.55	8.3	4.6	9.7x	7.5x	6.3x	2.7x	4.9x	HVS	
Median							-38%	-49%						8.9x	7.5x	6.3x	1.3x	1.7x		
S&P 500	SPX				1,278			-13%	-15%	95.50				525.73			14.1x	13.4x	NA	2.4x

(1) First Call Estimates for Morgan Stanley.

NC = Not Covered; PP = Patrick Pinschmidt; BG = Betsy Graseck; HVS = Huw van Steenis

Source: Company data, FactSet, Morgan Stanley Research E = Morgan Stanley Research estimates, except for Morgan Stanley, which is First Call



Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations. For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

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(as of May 31, 2008)

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	931	43%	297	46%	32%
Equal-weight/Hold	897	41%	261	40%	28%
Underweight/Sell	349	16%	92	14%	26%
Total	2,177		650		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

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Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

More volatile (V). We estimate that this stock has more than a 25% chance of a price move (up or down) of more than 25% in a month, based on a quantitative assessment of historical data, or in the analyst's view, it is likely to become materially more volatile over the next 1-12 months compared with the past three years. Stocks with less than one year of trading history are automatically rated as more volatile (unless otherwise noted). We note that securities that we do not currently consider "more volatile" can still perform in that manner.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

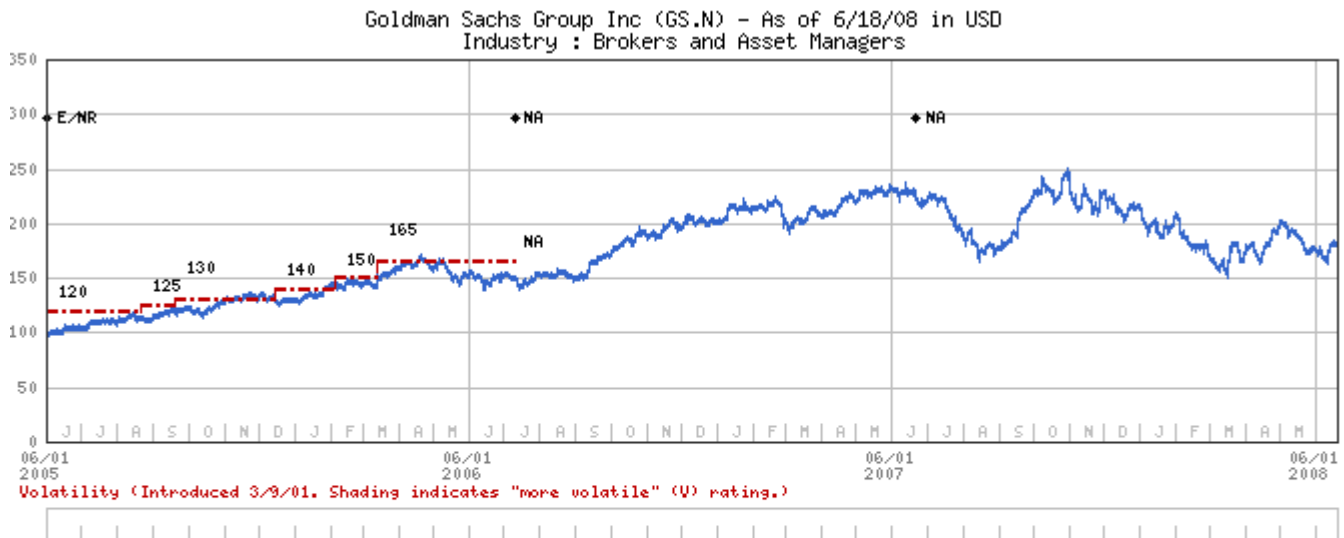
In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

June 30, 2008
Lehman Brothers

Stock Price, Price Target and Rating History (See Rating Definitions)

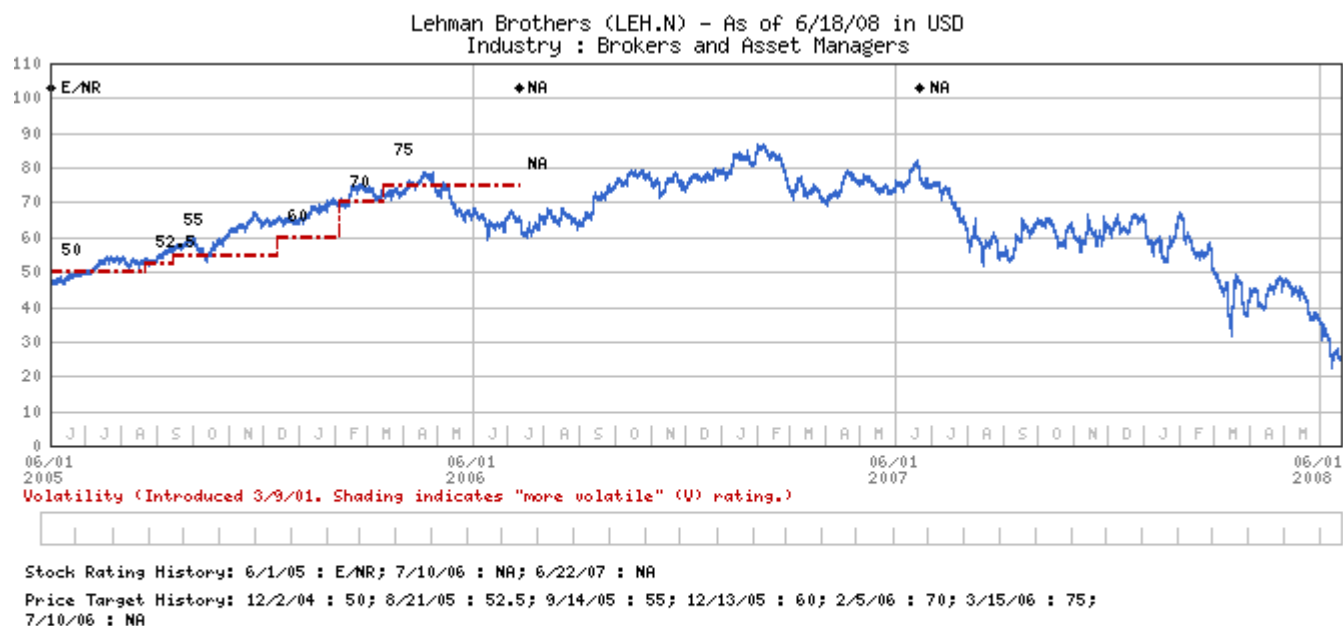


Stock Rating History: 6/1/05 : E/NR; 7/10/06 : NA; 6/22/07 : NA

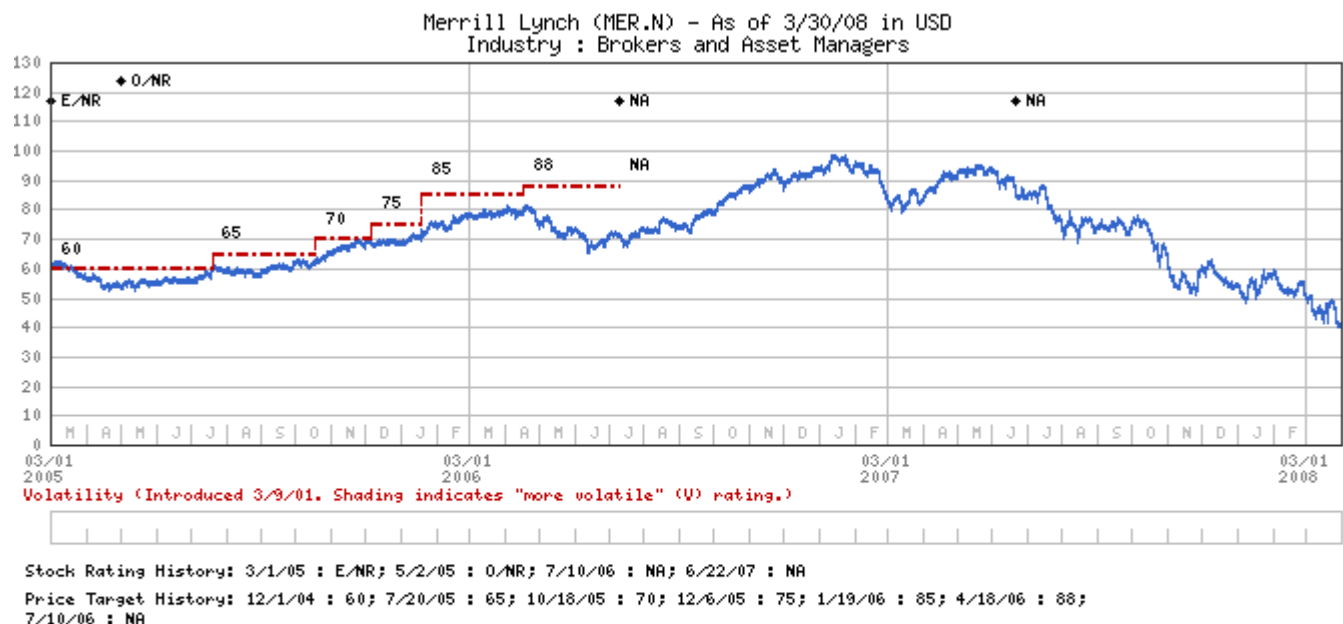
Price Target History: 12/1/04 : 120; 8/21/05 : 125; 9/20/05 : 130; 12/15/05 : 140; 2/5/06 : 150; 3/14/06 : 165;
7/10/06 : NA

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target --- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) --- Stock Price (Covered by Current Analyst) ---
Stock Ratings abbreviated as below (Effective 3/18/02, ratings appear as Stock Ratings/Industry View) ♦
Stock Ratings as of 3/18/02: Overweight (O) Equal-weight (E) Underweight (U) More Volatile (V) No Rating Available (NAU)
Stock Ratings prior to 3/18/02: Strong Buy (SB) Outperform (OP) Neutral (N) Underperform (UP) No Rating Available (NAU)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

June 30, 2008
Lehman Brothers



Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target --- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) --- Stock Price (Covered by Current Analyst) ■
Stock Ratings abbreviated as below (Effective 3/18/02, ratings appear as Stock Ratings/Industry View) ♦
Stock Ratings as of 3/18/02: Overweight (O) Equal-weight (E) Underweight (U) More Volatile (V) No Rating Available (NAU)
Stock Ratings prior to 3/18/02: Strong Buy (SB) Outperform (OP) Neutral (N) Underperform (UP) No Rating Available (NAU)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)



Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target --- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) --- Stock Price (Covered by Current Analyst) ■
Stock Ratings abbreviated as below (Effective 3/18/02, ratings appear as Stock Ratings/Industry View) ♦
Stock Ratings as of 3/18/02: Overweight (O) Equal-weight (E) Underweight (U) More Volatile (V) No Rating Available (NAU)
Stock Ratings prior to 3/18/02: Strong Buy (SB) Outperform (OP) Neutral (N) Underperform (UP) No Rating Available (NAU)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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Industry Coverage:Brokers

Company (Ticker)	Rating (as of)	Price (06/27/2008)
Patrick Pinschmidt		
Goldman Sachs Group Inc (GS.N)	O (06/30/2008)	\$174.56
Lehman Brothers (LEH.N)	O (06/30/2008)	\$22.25
Merrill Lynch (MER.N)	E (06/30/2008)	\$32.7

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