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Losers abound in Lehman's fall

By Aaron Elstein - Crain's New York

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Last week, Lehman Brothers Holdings Inc. shares plunged 77% as the firm posted the biggest loss in its 158-year history and investors scoffed at the recovery plan laid out by Chief Executive Richard Fuld.

Lehman's demise as an independent firm is a virtual certainty. And with an acquisition by another firm likely to result in cutbacks rivaling those seen at Bear Stearns Cos. after JP Morgan Chase absorbed it, the fallout will be staggering.

Topping the list of losers are Lehman's 25,000 employees, roughly a quarter of whom work in New York. Last year, the firm's global payroll totaled nearly \$10 billion, which works out to an average of \$332,000. Employees, who own 30% of their firm's stock, have already seen their wealth shrivel drastically, with the 95% drop in Lehman's shares this year wiping out \$15 billion of their net worth. Many of them now face losing their livelihood. Even in the best-case scenario—another bank swooping in to rescue Lehman—the job losses will be heavy.

“You could see 12,000 people on the street,” says Gustavo Dolfino, president of recruiting firm WhiteRock Group.

Landlords would also sorely miss Lehman. In addition to owning its 1 million-square-foot headquarters on Seventh Avenue, the firm rents 2.4 million square feet at pricey New York addresses, including 399 Park Ave. and 1271 Sixth Ave. Lehman paid \$250 million dollars in rent worldwide last year—a good slug of that amount going to Manhattan building owners. And it has committed to another \$1.4 billion in leases over the next four years.

“Any way you measure it, Lehman would be a huge tenant to lose,” says Michael Knott, an analyst at real estate research firm Green Street Advisors, who estimates that the bank rents more than 1% of midtown's prime commercial office space.

Wagers gone awry

The news could hardly be worse for Lehman's 411,000 shareholders, including several that, sure that a rebound was imminent, redoubled their bets in the spring. Lehman's No. 1 investor, Manhattan-based AllianceBernstein Holding, increased its stake by 43% in the spring, to 66 million shares.

The bank's fifth-largest owner, Wellington Management, upped its holdings by 75%, to 25 million shares. Even renowned hedge fund manager George Soros apparently got burned. In the spring he doubled his firm's ownership of Lehman, to 9 million shares.

Customers involved in complex trades with Lehman also stand to take major losses if the firm can't honor its financial commitments.

They have entered into \$44 billion worth of privately negotiated derivative contracts with Lehman and could suffer huge hits if enough of them get antsy about the ability of Lehman, which has just \$28 billion of capital, to make good on its agreements.

Bear Stearns' fate was sealed by such a loss of confidence. It is also a key reason the Federal Reserve Bank stands ready to lend Lehman what it needs to head off a run on the bank, though the Fed has yet to promise to extend the sort of guarantees granted to J.P. Morgan when it bought Bear.

Explosive situation

“This is a powder keg,” says Christopher Whalen, managing director at Institutional Risk Analytics.

But Lehman's predicament also represents a singular opportunity for some. Last year, the firm posted revenues of \$59 billion, all of which would be up for grabs by its competitors. The lion's share of that business would probably go to the big three surviving U.S. investment banks: Goldman Sachs, Merrill Lynch and Morgan Stanley.

Long known as a powerhouse in the global bond market, Lehman has branched out in recent years, making a name for itself in equities, derivatives and other areas. For example, it ranked as the No. 5 player in the lucrative business of advising U.S. companies on mergers and acquisitions in 2007, up from a distant No. 9 five years earlier, according to Bloomberg.

The biggest winner would be the investor or group of investors that manages to grab Lehman's best parts, which will be available for a song. Sanford C. Bernstein & Co. analyst Brad Hintz, a former chief financial officer at Lehman, says that apart from its toxic mortgage portfolio, the firm retains a strong investment banking franchise.

“This firm would be attractive to a lot of players if you could separate out the mortgages,” Mr. Hintz says.