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Insurance/Life

North America
Financial Services
Insurance/Life

Industry Overview

Everybody, Not Just MET, Shaving Tables

Eric N. Berg, CPA, CFA
1.212.526.2805
eberg@lehman.com

Sector View:

New: 2-Neutral
Old: 2-Neutral

Investment conclusion

- In the wake of MetLife's surprising recent announcement that it had taken a $250 mm reserve charge in connection with large-face-amount life insurance policies sold to older Americans, a new study by Lehman Brothers Life Insurance Research has reached its own surprising conclusion: Met probably isn't alone. The new Lehman study, based on a review of hundreds of pages of publicly available correspondence between life companies and their agents, finds that numerous carriers may be looking at reserve increases on their large-face, older-age policies. The reason: the curious practice in the life insurance industry, sometimes referred to as "table shaving," in which carriers offer healthy-people insurance rates to unhealthy applicants on the hope such underpricing can be offset elsewhere. Our study found that this practice has been widespread in the U.S. life insurance industry. It was not just a Travelers problem: it's everybody's problem. And while many insurance companies have already taken remedial action to eliminate or substantially limit the steep discounts they had been offering some, such as elderly customers buying large policies, our study concludes that the carriers may very well be in the same boat as Met, facing reserve increases. Among those life insurers that were offering significant discounts, then pulled back: JP, LNC, PL and MFC.

The following table summarizes our analysis of potential charges resulting from the programs sometimes referred to in the industry as "table shaving". According to our analysis, Jefferson Pilot, Protective, Lincoln and Manulife appear to be more exposed than other carriers due to the importance of the universal life business to these companies. Universal life, a form of permanent life insurance, has been a corner of the business where this practice has been prevalent.

Potential Charges in Universal Life
$mm

Company	Ticker	Universal Life Account Balances, 4Q05	Potential Charge, 6% of General Account	Operating Earnings, 2005	Potential Charge, % of Operating Earnings
Jefferson Pilot	JP	11,783	707	571	123.7%
Protective *	PL	4,236	254	264	96.4%
Lincoln	LNC	10,271	616	852	72.4%
Manulife **	MFC	32,354	1,941	2,711	71.6%
Sun Life ** (in CAD)	SLF	12,544	753	1,843	40.8%
Principal	PFG	3,493	210	862	24.3%
MetLife ***	MET	10,531	632	3,271	19.3%
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* - UL account balances for 3Q05
** - only discloses entire general accont in U.S. Individual Life operations
*** - MetLife has its own table-shaving program, separate from Travelers

Source: Company reports, Lehman Brothers research

PLEASE SEE ANALYST(S) CERTIFICATION(S) ON PAGE 9 AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 10

To be sure, we don't know for certain that these carriers will be recording charges. For one thing, reserve increases are entirely discretionary, i.e a judgment call by management. For another, carriers are sometimes justified in offering their preferred rates to unhealthy people if there are mitigating factors – for instance, if an overweight person suffering from heart disease is losing weight and taking cholesterol medication. Finally, virtually the entire life insurance industry has been a heavy user of reinsurance in recent years, and it's entirely possible that any losses owing to broadly based underpricing of large-face-amount, older-age life-insurance policies may be borne heavily by reinsurers.

Unusual indeed, however, would be the case of an insurance company that reinsured 100 % percent of its policies. And one of the main conclusions of our study is that all too often unhealthy people have gotten healthy-people rates automatically, i.e. for no good reason. It's been part of a larger effort by carriers to show continued top-line momentum in the face of an industry-wide top-line slowdown or to stay in the good graces of particularly productive agents. It would be one thing if underpricing from this practice was being made up elsewhere. The fact, however, that our study found several instances in which insurance companies chose to loosen their underwriting standards on bigger policies, then tighten those standards back up significantly, leads us to the following conclusion: We believe more charges like Met's are likely.

Our data are shown below. The table is meant to provide a review of the activities of some of the largest public traded life insurers in the United States. Investors should focus on the right column, which tracks how various such programs evolved over time. To us, the pattern is clear: Met certainly wasn't the only insurer pursuing older, wealthier, life-insurance applicants with discounts. In instance after instance, we believe other carriers were in the market with significant discounts under similar types of initiatives. The fact that these carriers then moved repeatedly to scale back the initiatives tell us that, in all likelihood, the carriers concluded that the policies had been underpriced.

Discount Programs for People with Less Than Perfect Health in the Universal Life Market

Company	Tables Shaved	Maximum Coverage	Maximum Age	Program Introduced	Changes Since Inception
AIG / American General	Table 2 to Standard	$10mm	80	n/a	*3Q04:* Program discontinued
AXA-Equitable	Table 3 to Standard	Single Life: $10mm Joint Life: $20mm	80	March 2003	*March 2005:* Maximum age reduced from 80 to 70; For survivorship plans - limited eligibility to one life.
The Hartford	Table 4 to Standard	$10mm	Single Life: 80 Joint Life: 70	July 2001	*January 2005:* Maximum age reduced from 75 to 64 on Advanced UL; Maximum face amount increased to $10mm
ING	Table 4 to Standard	$5mm	80	December 2002	*September 2004:* Decreased number of tables shaved from 4 to 2; Maximum issue age increased to 80. *January 2006:* Program discontinued
Jefferson Pilot	Table 4 to Standard	$10mm	80	January 1998	*November 2003:* Increased Face Amount from $5mm to $10mm; *July 2005:* Decreased max tables shaved for survivorship policies; Decreased max age from 80 to 75; U/W credits can no longer be used
John Hancock	Table 4 to Standard	$5mm	80	Late 2003	*January 2005:* Decreased number of tables shaved from 4 to 3; *February 2006:* Increased pricing of UL policies for ages above 70
Lincoln Financial	Table 3 to Standard	$10mm	80	January 2005	*January 2006:* Decreased max age to 70 from 80.
Metlife / General American	Table 4 to Standard	$10mm	Single Life: 75 Joint Life: 80	n/a	*May 2005:* Decreased number of tables shaved from 4 to 3; Decreased max face amount to $5mm from $10mm for ages above 70
Principal	Table 4 to Standard	$5mm	75	May 2001	*May 2005:* Limited dump-in premiums, decreased compensation; Significantly raised UL prices.
Protective / West Coast	Table 4 to Standard	$5mm	75	n/a	*January 2005:* Program discontinued. *December 2005:* Competitive UL products discontinued, rates increased on other UL products
Prudential	Table 2 to Preferred	*Single Life:* $5mm to age 75, $2.5mm to age 80. *Joint Life:* $10mm to age 75, $5mm to age 80.	80	February 2002	*January 2006:* Program discontinued
Sun Life	Table 2 to Standard	Up to age 70: $25mm Over age 70: $18mm	75	n/a	*January 2006:* Program discontinued
Travelers	Table 3 to Standard	$10mm	80	August 2001	*July 2003:* Increased max age to 80; *April 2005:* Decreased max age to 75; Decreased max face amount to $5mm for ages below 70 and $2.5mm for ages above 70. *May 2005:* Decreased compensation on sales to clients over 65; *January 2006:* Program discontinued

Source: independent agents, Lehman Brothers research

Discounts on Premium Rates to Individuals in Less Than Perfect Health: Loss Leader -- or Just a Money-Losing Idea?

The fact that so many life insurers have engaged in this practice in recent years tells us it's anything but obvious that the concept is fundamentally flawed. In its simplest form, this is straightforward: It's giving a life insurer's better rates to a customer who, because of a health condition, would normally be surcharged. Life insurers all use essentially the same tiering system to classify customers, with applicants in perfect health classified as "super preferred" or "preferred" and with customers who are modestly overweight or hypertensive considered "standard." When a person is badly overweight or hypertensive, of if an applicant has a history of significant illness, that person is assigned to one of five actuarial tables – typically called Tables A through D, or Tables 1 through 4 – that call for substantial surcharges. The practice known as "table shaving", then, is really quite simple: It's giving standard or preferred rates to customers whom the insurance company knows should be assigned to the lower tables. And for customers and their agents who participate in such activities, the savings can be substantial. A Table B to standard move, for instance, can shave more than 50 % off of the price of a policy.

Why do carriers do this? We suggest two reasons: 1) to get business in general and 2) even more important to keep in the good graces of agents who over the years have sent them lots of business. The more important question is whether the whole concept is flawed. That would seem to be the case since the upgrade to a better rate under the so-called "table shaving" programs rarely involves the customer's demonstrating mitigating health factors – and typically involves the writing agent's simply asking for a better rate. In this sense, this practice is not all that different from a business traveler's getting a free upgrade to a suite at a luxury hotel just by asking: The upgrade is coming right out of the hotel's profit margins. Nor is there evidence that we are aware of demonstrating that such "table shaving" programs can be a loss leader, i.e. programs run on the *hope* that the loss can be offset elsewhere. Such a "greater fool theory," i.e. that life insurers can overcharge healthy people to make up for table-shaving losses, just doesn't fly in an industry as fiercely competitive as life insurance.

This is why, in the end, we believe this practice *is* probably a fundamentally flawed idea and why the large charge taken by MetLife – we believe in connection with a similar program that simply didn't work out as hoped at Travelers – has implications extending beyond Met. At the highest level, the charge reflects the excess capacity that has plagued life insurance seemingly forever. For investors, however, the more important implication is what Met's outsized charge says about the health of other carrier's large-face-amount, older-aged policies. Our call this morning: If the evidence we were able to surface indicating that dozens of carriers engaged in similar initiatives, then pulled back, it's only a matter of time before investors get hit with more negative surprises similar to Met's.

And Met's charge did, indeed, catch many investors off guard. While the combination of Met and Travelers is going well in certain respects – for example, Met's annuity sales continue to be among the industry's strongest, and a joint venture that Travelers has had with Mitsui Sumitomo in Japan also is also off to a strong start -- the charge that Met recorded in the December quarter is effectively an acknowledgement by Met that a quarter of a billion dollars in value that Met thought already existed inside Travelers must now be reassigned to goodwill. In life insurance, goodwill is an asset the value of which is always something of a question mark since it represents the present value of profits insurers expect to materialize from *future* sales.

Met's management has stated that Met's actuaries will continue going through Travelers' book of business and will finalize their assessment of Travelers' reserve adequacy by the middle of 2006. Because Met has commented only limitedly about the causes of the reserve change, we suspect many investors are finding it difficult to forecast whether more charges loom at MET, and whether this whole matter could spill over into reserve charges or deteriorating profitability for other companies in the industry.

We answer the second question in this report. In summary, we believe that because of the table-shaving programs that were apparently common in life insurance in the first half of this decade, many other life companies that sold significant amounts of coverage to older-age customers are now facing elevated risks of having to take similar charges -- or accept lower profitability. Just as it is rarely the case that one commercial bank ends up with a slug of bad loans, we're saying that in all likelihood Travelers was one of *many* insurers offering seniors rates that were too low.

We Do Not Know for Certain that This Practice Was Behind Met's Charge – and Is About to Cause Earnings Problems for Other Carriers? But Does the Evidence Point in that Direction? Absolutely.

Admittedly, we don't absolutely know for sure that Met's large charge was a result of this process. What we're saying in this note is that the preponderance of the evidence points in this direction – not just at Met but throughout the industry.

For example, well before Met announced in January 2005 that it would spend $11.5 billion to acquire the life insurance business of The Travelers, the life insurance industry was buzzing with unsubstantiated speculation that Travelers was on the auction block – and was loosening its underwriting standards across the board to keep top-line growth going and dress itself up for a sale.

What's interesting is that our study found this *wasn't* the case; we weren't able to surface *any* evidence that Travelers had been cutting corners broadly in underwriting around the time of its sale. If anything, we found that generally speaking Travelers prices were solidly in the middle of the pack for many categories of applicants.

We show our data below.

The first thing that needs to be pointed out is that the data are *not* meant to illustrate "table shaving" since the prices given illustrate how much *healthy* people would pay for coverage. Such an exhibit would show how a substandard applicant could get standard or preferred rates. Excerpts from table-shaving ads are given in the appendix to this report.

With that as a preamble, we note the following:

First, late in 2004, both Travelers and Met were anything *but* low men on the totem pole when it came to pricing of universal life insurance for healthy, 55-year-old men. If anything, these two carriers' prices were toward the high end of the range.

Second, by early 2006, Met's prices still weren't at the bottom of those of peers. In fact, Met's 2006 price of $11,658 is actually *below* the $11,966 charged by Travelers two years earlier. The fact that Met has actually *dropped* its price modestly on this age category – the reason Travelers does not appear in the right-hand exhibit is that Met is no longer marketing under the Travelers name – tells us that Met did not believe there was a problem with this category of customer and with the price being charged by Travelers.

We repeated this exercise for healthy 75-year-old men – and reached the same conclusion as we did with the 55 year olds. Met and Travelers two years ago weren't pricing their universal life policies aggressively relative to competitors' prices. And after Met last July took control of Travelers and had a chance to review the prices being offered by Travelers to genuinely healthy older men, Met concluded that the Travelers price was appropriate. The "new" Met price is only modestly above the old Travelers price: $34,940 versus $34,469.

Annual Minimum No-Lapse Premium for $1,000,000 Universal Life Coverage

Late 2004

Best class, male	**Age 55**
Principal	10,590
Empire General	10,898
Equitable	11,319
Lincoln National	11,687
American General	11,696
Hartford Life	11,698
John Hancock	11,717
Travelers	**11,966**
MetLife	**12,210**
ING Reliastar	12,230
Jefferson Pilot	12,249
Transamerica	12,290

Early 2006

Best class, male	**Age 55**
Equitable	11,319
Jefferson Pilot	11,339
John Hancock	11,644
MetLife	**11,658**
Lincoln National	11,687
American General	11,696
Hartford Life	11,698
Prudential	11,731
Allianz Life	11,758
Protective Life	11,923
Principal	12,248
Transamerica	12,188
ING Reliastar	12,498

Late 2004

Best class, male	**Age 75**
Principal	30,352
Equitable	33,384
Jefferson Pilot	33,484
Lincoln National	33,487
American General	33,661
Travelers	**34,469**
MetLife	**34,945**
ING Reliastar Life	35,061
Transamerica	36,100
John Hancock	36,267
Hartford Life	37,492
Empire General	37,862

Early 2006

Best class, male	**Age 75**
John Hancock	30,589
Equitable	33,384
Lincoln National	33,487
Jefferson Pilot	33,515
American General	33,661
Transamerica	34,138
MetLife	**34,940**
ING Reliastar Life	35,829
Hartford Life	37,492
Prudential	37,836
Protective Life	39,862
Principal	40,436
Allianz Life	N/A

Source: Full Disclosure, National Underwriter, independent agents, Lehman Brothers research

Our conclusion is that Travelers did not have a broadly based underwriting problem. The issue that led to Met's charge must have been something quite specific.

What Else Leads Us to Our Conclusion?

We were also led to researching this "table shaving" phenomenon because in the press release associated with its December-quarter earnings report Met said that the charge related to a specific group of policies. In the conference call that followed, Met executives never used the phrase "table shaving" but they did say that the charge related to large-face-amount contracts. And afterwards, when we spoke to Met, we learned that Met decided to take the charge after reviewing the underwriting that Travelers had done on a small group of large-face-amount policies that had been sold to older applicants and concluding that there had been "inconsistencies" between Travelers' underwriting and the underwriting that would have been done by Met if it had issued the policies.

In other words, what apparently happened is that after July 1, when Met took control of The Travelers and was able to "get in there" and conduct in-depth due diligence on Travelers' applicant screening, Met concluded that it would have reached very different underwriting decisions on these applicants than Travelers did. To us that says it all: It was a case of underwriting practices with which Met simply wasn't comfortable.

How did We Estimate the Potential Impact of Reserve Increases?

Because all major companies at some point in the last five years had aggressive table-shaving programs, we need to scale the potential impact of these programs to put them in the context of consolidated company results. Knowing that MetLife took a $234mm reserve increase related to Travelers, which is approximately 6% of the universal life account balances added through the acquisition, we multiply each company's universal life balance by 6% to arrive at the total potential charge to earnings. We then divide this potential charge by the operating earnings in 2005 to arrive at each company's exposure as a percentage of earnings. The following table summarizes the results of the analysis:

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Source: Company reports, Lehman Brothers research

Appendix – Excerpts from Carriers' Letters to the Brokers

The following are some excerpts from the communications of carriers with brokers that refer to roll-out and scaling back of table-shaving programs. All of these letters were obtained from publicly available information on the websites of various insurance agents and brokers.

Travelers
Changes to Underwriting Capacity
Providing capacity for large cases continues to be a challenge for the life insurance industry. Travelers Life & Annuity understands the importance of supporting large cases for our distributors. Recent negotiations with our reinsurers leads us to announce the following changes:

T.I.P. Program (Table 3 to Standard Life Incentive Program):

	Maximum Per Life	
Issue Age	Old Program	New Program
0-70	$10 million	$5 million
71-75	$10 million	$2.5 million
76-80	$10 million	$0

Source: Travelers

Q: Why is this change to the T.I.P. program necessary?
A: Product pricing must consider all features offered including underwriting programs and reinsurance support. These changes support our overall product offering.
Q: Are there any alternatives to these changes?
A: Yes. A product pricing increase. We will continue to monitor for trends and opportunities as appropriate.

Great News On TL&A Life Products
Previous plans to sunset the products effective December 31, 2005 have been delayed to ensure a smooth transition to the new 2006 Series Contract.
The TL&A Table Shaving program will be eliminated for all life applications dated on or after January 15, 2006.

Jefferson Pilot
Changes to Our Automatic Reduction To Standard (ARTS) Program
We have spent a great deal of time reviewing the environment as well as our position with our reinsurers. It is with thorough consideration of all options that we announce changes to our current table-shave program. We believe that these changes achieve the necessary adjustments from a reinsurance standpoint while still allowing for a very strong table-shave program that remains a leader among our competitors.

ING
On October 1, 2004 the current ING table shave program will change from "Table 4 to Standard" to a "True Table 2 to Standard."
Why the change?
Due to significant reinsurance cost increases, the cost of the current program puts the competitiveness of all future product offerings at risk.

West Coast Life/Protective
Table D to Standard Expanded OpportunityProgram
Beginning June 1, 2004, West Coast Life introduces expanded eligibility for clients who would have been in the Table A, Table B, Table C or Table D rating to qualify for Standard (either NonTobacco or Tobacco) rates, subject to certain restrictions.

Important Notice! Table D to Standard Program Discontinued as of 12/31/04!
Due to changes in our reinsurance partnerships, West Coast Life is ending the Table D to Standard Expanded Opportunity Program effective December 31, 2004.

Table Shave Programs
Recent changes in reinsurance agreements have forced Protective Life to discontinue to offer the Classic UL in their Table Shaving Program.
Applications need to be signed by October 31, 2004 to qualify for table shaving.

Prudential Financial:
TABLE B TO PREFERRED NON-SMOKER
Prudential offers expanded eligibility for Preferred Non-Smoker to new business clients who qualify. Clients who would have been in the Non-Smoker, Non-Smoker Table A or Non-Smoker Table B rating may receive Preferred Non-Smoker rates. This was implemented to increase underwriting flexibility by offering a more favorable underwriting category to those clients who meet certain guidelines.

Prudential Financial Gives Your Clients "Credit" - Table Shave Program Discontinued
...we are eliminating our Expanded Preferred Non-Smoker Program, effective 12/30/05.

Lincoln
Table C to Standard:
An industry unique program that gives us the ability to take a case with total final mortality of up to Table C at standard rates. This program is available to individuals up to and including age 70 for amounts of up to $10,000,000 inclusive per life, on permanent individual and second to die products.

MetLife
Table Shaving Program Changes
MetLife is committed to providing you with a competitive Table Shaving program. Research indicates several of our competitors have put restrictions on Table Shaving or have eliminated their programs all together.

Sources: Insurance brokers' web sites, Lehman Brothers equity research

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Analyst Certification:
I, Eric N. Berg, CPA, CFA, hereby certify (1) that the views expressed in this research Industry Note accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Industry Note and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Industry Note.

Other Team Members:
Blinchik, Pavel 1.212.526.1239 pblinchi@lehman.com

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Company Name	Ticker	Price (17-Feb-2006)	Stock / Sector Rating
Hartford Financial	HIG	$ 83.65	2-Equal weight / 2-Neutral
Jefferson-Pilot	JP	$ 59.37	RS-Rating Suspended / 2-Neutral
Lincoln National	LNC	$ 55.83	RS-Rating Suspended / 2-Neutral
Manulife Financial	MFC	CAD 72.90	2-Equal weight / 2-Neutral
MetLife Inc	MET	$ 50.18	2-Equal weight / 2-Neutral
Nationwide Financial Svcs	NFS	$ 42.97	3-Underweight / 2-Neutral
Principal Financial Group	PFG	$ 48.01	2-Equal weight / 2-Neutral
Protective Life	PL	$ 48.41	2-Equal weight / 2-Neutral
Prudential Financial Inc	PRU	$ 75.32	3-Underweight / 2-Neutral
Sun Life Financial	SLF	CAD 49.40	2-Equal weight / 2-Neutral

Other Material Conflicts

JP: Lehman Brothers is acting as an advisor to Lincoln Financial on the proposed merger with Jefferson Pilot.

LNC: Lehman Brothers is acting as an advisor to Lincoln Financial on the proposed merger with Jefferson Pilot.

Sector Coverage Universe
Below is the list of companies that constitute the sector coverage universe:

AFLAC INC (AFL)
Ameriprise Financial (AMP)
AmerUs (AMH)
Delphi Financial Group (DFG)
Genworth Financial (GNW)
Hartford Financial (HIG)
Jefferson-Pilot (JP)
Lincoln National (LNC)
Manulife Financial (MFC)
MetLife Inc (MET)
National Financial Partners (NFP)
Nationwide Financial Svcs (NFS)
Phoenix Companies (PNX)
Principal Financial Group (PFG)
Protective Life (PL)
Prudential Financial Inc (PRU)
Reinsurance Group of America (RGA)
Scottish Re Group (SCT)
StanCorp Financial Group (SFG)
Sun Life Financial (SLF)
Torchmark Corp (TMK)
UnumProvident Corp (UNM)

Guide to Lehman Brothers Equity Research Rating System:
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In addition to the stock rating, we provide sector views which rate the outlook for the sector coverage universe as 1-Positive, 2-Neutral or 3-Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

Stock Rating
1-Overweight - The stock is expected to outperform the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.
2-Equal weight - The stock is expected to perform in line with the unweighted expected total return of the sector coverage universe over a 12- month investment horizon.
3-Underweight - The stock is expected to underperform the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.
RS-Rating Suspended - The rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Lehman Brothers is acting in an advisory capacity in a merger or strategic transaction involving the company.

Sector View
1-Positive - sector coverage universe fundamentals/valuations are improving.
2-Neutral - sector coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.
3-Negative - sector coverage universe fundamentals/valuations are deteriorating.

Distribution of Ratings:
Lehman Brothers Equity Research has 1859 companies under coverage.
43% have been assigned a 1-Overweight rating which, for purposes of mandatory regulatory disclosures, is classified as Buy rating, 35% of companies with this rating are investment banking clients of the Firm.
40% have been assigned a 2-Equal weight rating which, for purposes of mandatory regulatory disclosures, is classified as Hold rating, 6% of companies with this rating are investment banking clients of the Firm.
17% have been assigned a 3-Underweight rating which, for purposes of mandatory regulatory disclosures, is classified as Sell rating, 76% of companies with this rating are investment banking clients of the Firm.

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